Supreme Court, U.S.
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No. 02-

IN THE

Supreme Court of the United States

MARTIN D. FIFE and FAROUK A. KHAN,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. The decision of the court of appeals, while acknowledging the limited authority of the Securities Exchange Commission to pursue alleged securities law fraud claims under sections 10(b) of the Securities Exchange Act, SEC rule 10b-5 promulgated thereunder and Section 17(a) predicated upon the acts complained of having been "in connection with the purchase or sale of securities," affirmed injunctive relief freezing all of Petitioners' assets without any evidence of a misrepresentation or omission "in connection with the purchase or sale of a security" and where the district court decision and Record established that the "in connection with" requirement had not been satisfied.

The question presented is whether the court of appeals' decision conflicts with the Securities Laws and constitutes judicial legislation in violation of the separation of powers doctrine.

2. The SEC requested injunctive relief freezing all of Petitioners' assets. The SEC submitted no admissible evidence or even any inadmissible evidence satisfying the statutory requirement of the alleged securities law fraud claims upon which it based its request for injunctive relief. The lower courts nonetheless approved the SEC's request and granted injunctive relief.

The question presented is whether the asset freeze granted by the lower courts, not supported by any admissible evidence, violates the Petitioners' Fifth Amendment right not to be deprived of property without due process of law.

3. Whether section 202 of the Investment Advisers Act includes in its definition of "adviser" persons who have no agreement for payment with client.

LIST OF PARTIES

In addition to the Petitioners, there were seven other defendants and one relief defendant named by the SEC in this action. Several of these defendants were unable to be served. Neither the unserved defendants nor any of the other defendants joined in Petitioners' appeal to the court of appeals that underlies this petition for a writ of certiorari.

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Petitioners respectfully petition for a Writ of Certiorari to review the judgment of the First Circuit Court of Appeals in this case.

OPINIONS BELOW

The First Circuit opinion (Appendix ("Pet. App.") 1a-21a) is reported at 311 F.3d 1. The district court opinion (Pet. App. 59a-81a) is unreported.

STATEMENT OF JURISDICTION

The judgment of the First Circuit Court of Appeals was entered on November 6, 2002. The jurisdiction of this court is invoked pursuant to 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the following constitutional and statutory provisions:

A. Article I of the United States Constitution, stating, in pertinent part, "all legislative powers herein granted shall be vested in a Congress of the United States . . ."

B. Article III of the United States Constitution, stating, in pertinent part, "the judiciary power of the United States, shall be vested in one supreme Court, and in such inferior courts as the Congress may from time to time ordain . . . and shall extend to all cases, in law and in equity . . . [and] controversies . . ."

C. Fifth Amendment to the United States Constitution, stating, in pertinent part, "No person shall be . . . deprived of . . . property, without due process of law."

D. 15 U.S.C. § 78(j)(b), Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder. In relevant part, Rule 10b-5 makes it unlawful for any person: "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security."

E. 15 U.S.C. § 77q(a), Section 17(a) of the Securities Act of 1933. In relevant part, Section 17(a) provides, "It shall be unlawful for any person in the offer or sale of securities . . . by the use of any means or instruments of transportation or communication in interstates commerce or by the use of the mails, directly or indirectly . . . to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading . . ."

F. 15 U.S.C. § 80(b), Section 202(a)(11) and 206 of the Investment Advisers Act. Section 202(a)(11) of the Investment Advisers Act defines "investment adviser" as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to

the value of securities or as to the advisability of investing in, purchasing or selling securities." 15 U.S.C. § 80(b)(2)(11). The Investment Advisers Act prohibits fraud by those who act as investment advisers. 15 U.S.C. § 80b-1.

STATEMENT OF THE CASE

In April 2002, Petitioners were named in a sweeping complaint alleging securities fraud against nine defendants. Pet. App. 59a-60a. There is no dispute that some of the defendants most assuredly violated the securities laws by soliciting investments based on materially false and misleading representations. The SEC charged Petitioners, neither of whom solicited a single investor in connection with any investment that was ever made by anyone, with primary violations of section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder and section 17(a) of the Securities Act of 1933. Petitioner Martin D. Fife was also charged with violating section 206 of the Investment Advisers Act (the "Advisers Act").

Based on actions by defendants other than Petitioners to secret and divert the fruits of converted investor funds, the SEC sought a temporary restraining order and preliminary injunction freezing the assets of the defendants, including those of Petitioners. After a two day "evidentiary" hearing, where the sole witness was an SEC attorney who admittedly had no personal knowledge and could not authenticate any of the documents introduced through his testimony, the district court granted the preliminary injunction and asset freeze against all defendants. Pet. App. 22a-58a.

Inconsistent with its Order, the district court's factual findings were, however, consistent with the testimony and evidence provided by the SEC. That testimony and evidence established that Petitioners had not solicited any of the investments at issue in the action and that neither Petitioner had made any alleged misrepresentations or omissions "in connection with the purchase or sale of any security."

Petitioners challenged the injunction and asset freeze on the grounds that there was no evidence to support the underlying claims and hence the claims against Petitioners were beyond the scope of the SEC's authority.[1] Even allowing inadmissible evidence to serve as the sole predicate for the district court decision, the "in connection with" requirement and the "investment adviser" requirement had not been established by the SEC.

In its opinion, the First Circuit, after properly acknowledging the "in connection with" requirement of the securities anti-fraud statutes, identified the allegedly fraudulent conduct engaged in by Petitioners. However, the First Circuit carefully avoided any mention of the undisputed fact that all of the allegedly fraudulent conduct that it

1. While the actions of Petitioner Fife, who did not even have any contact with any investor until after their investments had been made, could arguably give rise to claims by one or more investors under common law, the SEC's authority under the federal securities laws is more limited. The requirement that any alleged fraud be "in connection with" the purchase or sale of securities limits the SEC's jurisdiction to the pursuit of a specific category of alleged frauds. The elimination of the "in connection with" requirement, which the SEC has sought from Congress for years, would permit the SEC to pursue fraud claims untethered to any investment decision by an investor, the precise class of persons to be protected by the SEC. Khan had nothing to do with any completed investment by anyone.

identified occurred after all of the investments sued upon had been made. Pet. App. 62a-64a. The First Circuit identified specific items of post-investment letters written by Petitioners, finding them to be misleading. However, the First Circuit omitted any mention of the undisputed fact that none of these items of correspondence produced a single penny of investment. As a result, while having acknowledged the necessity of satisfying the "in connection with" requirement, the First Circuit actually ignored established precedent and effectively wrote this requirement out of the law. In so doing, the First Circuit vastly exceeded the limitations inherent in this Court's recent opinion in *SEC v. Zandford*, 535 U.S. 813, 122 S. Ct. 1899 (2002) in affirming the preliminary injunction and asset freeze.

1. Petitioner Fife is 75 years of age. Khan has been associated with Fife for the past four or five years. For nearly 30 years, Fife has been an outside director/trustee of the Dreyfus Funds. Fife has never been the subject of any SEC or state or federal inquiry.

In 1999, Fife was approached by Johan Hertzog (whom he knew slightly), who told him that he (Hertzog) and a Michael Clarke (whom Fife never met) had formed a company known as Brite Business, S.A. ("Brite"). Pet. App. 61a. Brite was going to raise money from investors and Hertzog and Clarke were interested in participating in government-sponsored projects overseas. Fife and Khan had an interest in helping to develop third world projects (a fish hatchery farm in Mexico and a pre-fabricated housing project in India). Fife agreed to administer Brite's funds for these purposes.

It is undisputed that Petitioners had nothing to do with soliciting or obtaining any investments in Brite. *See* Pet. App. 3a, 62a. Indeed Khan had nothing whatsoever to do with Brite. *See* Pet. App. 10a-11a. Petitioners never saw any of the investment contracts, all of which were solicited by and entered into by Clarke, Hertzog or other defendants in this action. Petitioners never even met or spoke to any investors until after their investments had been made. Pet. App. 62a-64a. Fife's sole involvement in this matter was to supervise funds that Clarke and Hertzog caused to be deposited into a Brite account over which Fife had authority.

Fife likewise never provided investment advice to investors or prospective investors because he had virtually no involvement with investors. Petitioner Khan never communicated with a single investor about any investment and Fife only spoke with two investors, both after their investments had been made and not for purposes of rendering investment advice.

Fife never received compensation of any type from any investor or from Brite, let alone receiving any compensation for any investment advice, nor was there ever any agreement between Fife and Brite or any investor regarding compensation. As the First Circuit noted, at most, Fife had an expectation that, if any investments that might be made in various third world projects proved successful, he would be able to reach an agreement to be compensated by Hertzog (not by any investor) but no such agreement was ever discussed or reached. Pet. App. 20a.

2. The SEC began an investigation of defendant Herula (a broker at Raymond James who had solicited the investment of two investors with false promises) in December 2001.

Pet. App. 4a n.1. The SEC requested interviews with Petitioners and Petitioners fully cooperated with the SEC. *Id.* In April 2002, the SEC filed an action in the District Court of Rhode Island alleging federal securities law violations against nine defendants and was granted an *ex parte* temporary restraining order and asset freeze against Petitioners and other defendants.

Failing to effectuate service upon the people who admittedly solicited the investments (and who appear to have misappropriated the invested funds), the SEC has instead pursued Petitioners as soft targets of opportunity. The SEC's own investigation and evidence established that Petitioners were utterly uninvolved in soliciting any investors or investments. The SEC's own investigation and evidence established that Petitioners had no involvement whatsoever in connection with the purchase or sale of securities. The SEC's own investigation and evidence established that Fife did not act as an investment adviser to the Brite investors.[2]

3. Despite these comprehensive deficiencies, the district court sweepingly granted the SEC's motion and froze all of Petitioners' assets, including those admittedly unrelated to the alleged securities fraud. Pet. App. 35a-41a. The district court decision does not identify a single act by Petitioners that constitutes a violation of the provisions alleged by

2. The SEC did not allege and did not offer any evidence that Fife was involved in a conspiracy, thereby somehow making him a participant in or liable for the actions of the other defendants and there is nothing in either of the decisions below reflecting any alleged conspiracy. Rather, Petitioners are being judged solely on their own actions and those actions are completely outside the purview of the SEC and the securities laws.

the SEC. Indeed, the district court's factual recitation of the allegedly fraudulent conduct of Petitioners establishes that, absent the elimination of the "in connection with" requirement, Petitioners could not have committed a securities law violation.

The district court found that Rheaume Holdings (one of the two investors defrauded) allegedly entered into an investment agreement with Brite in March 2000 based on fraudulent statements by Herula, Clarke and Wachtel. However, it was undisputed that Fife had no contact with Rheaume until at least May 2000. Pet. App. 68a-69a. The other defrauded investor, Al Bloushi (also solicited it appears by Clarke), never had any contact whatsoever with Fife, before, during or after his investment. Pet. App. 66a-67a. The district court also noted that the only alleged representations by Khan to an investor were in connection with an investment that "was never consummated." Pet. App. 67a. The district court also found that with regard to allegedly misrepresentative letters written by Fife and Khan, "[t]here is no evidence that those letters were ever distributed to investors." Pet. App. 65a. These letters, which constituted the only even arguable solicitations by Fife and Khan that the district court identified, never resulted in a single penny being invested by anyone in anything. In short, absent a judicial rewriting of the securities laws to eliminate the "in connection with requirement," the district court's findings can not support a preliminary injunction and asset freeze based upon an alleged violation of the securities laws.

4. On appeal, the First Circuit, while ostensibly acknowledging the "in connection with" requirement, affirmed a district court decision that plainly reflected that Petitioners had not engaged in any proscribed acts

"in connection with" the purchase or sale of securities.[3] The primary argument on appeal – and indeed the bulk of Petitioners' brief to the First Circuit – focused on the SEC's failure to provide any evidence satisfying the essential "in connection with" requirement. However, the First Circuit did not even bother to address this point, offering only the statement – wholly inconsistent even with the district court's decision – that the element had been met. Pet. App. 19a.

The SEC relied heavily on this Court's ruling in *United States v. Zandford*, 535 U.S. 813, 122 S. Ct. 1899 (2002) in its brief to the First Circuit. The thrust of the SEC's argument was that *Zandford* broadened the scope of the "in connection with" requirement to the point where it was no longer an element requiring proof.[4] The First Circuit, consistent with its studied effort to ignore the precise "in connection with" question advanced on the appeal, chose not to expressly address the SEC's *Zandford* argument, preferring simply to

3. The First Circuit's own identification of the alleged fraudulent acts committed by Fife and Khan similarly did not satisfy the "in connection with" requirement, the applicability of which the First Circuit nonetheless acknowledged. Its affirmance of the district court decision can therefore only be squared with the elimination of this requirement.

4. As discussed below, the SEC has repeatedly requested that Congress eliminate the "in connection with" requirement and just as repeatedly, Congress has rejected the SEC's attempt to broaden its anti-fraud authority in this respect. Having failed to obtain congressional amendment of the securities anti-fraud statutes, the SEC has plainly turned to the Courts in the hope (thus far realized in this case) that its efforts in this regard might find a more receptive audience. However, the judicial law making engaged in by the First Circuit violates the plain language of the statute and violates the separation of powers doctrine.

acknowledge the "in connection with" requirement and state that it had been satisfied, referring to conduct that could not possibly have satisfied it. Based on the record and the district court decision, the First Circuit could not have affirmed without accepting the SEC's *Zandford* argument and reading the "in connection with" requirement out of the securities laws.

It is respectfully submitted that this Court should clarify that while *Zandford* recognizes a flexible application of the "in connection with" requirement, *Zandford* does not eliminate the "in connection with" requirement. Nor does *Zandford* hold that the courts do not have to weigh the evidence relating to that element prior to freezing a person's assets. This Court should clarify that, if the SEC is to obtain an expansion of its enforcement jurisdiction, that expansion must come from Congress and not by way of a judicial rewriting of the securities laws to eliminate the "in connection with" requirement.

REASONS FOR GRANTING THE PETITION

I. The Decision of the First Circuit Conflicts With The Securities Laws, Violates The Separation Of Powers Doctrine And Misconstrues This Court's Decision In *Zandford*

Although the "in connection with" requirement has been flexibly applied by the Courts to accomplish the purposes contemplated by the securities laws, it has never been eliminated. Here, however, the district court and First Circuit have effectively eliminated the requirement entirely. This is in conflict with the statutory and decisional law. *See, e.g., Flickinger v. Harold C. Brown & Co.*, 947 F.2d 595, 598 (2d Cir. 1991) (to satisfy the "in connection with" requirement, the alleged

fraud must have been integral to the plaintiff's purchase or sale of the security); *Taylor v. First Union Corp.*, 857 F.2d 240, 245 (4th Cir. 1988), *cert. denied*, 489 U.S. 1080 (1989) (the "in connection with" requirement is not satisfied by tangential or incidentally related actions to the sale or purchase of security).

The lower courts' stealth elimination of the "in connection with" requirement is contrary to congressional intent that this requirement remain as a statutory limitation on the authority of the SEC, barring it from pursuing common law fraud claims. The SEC has twice asked Congress to eliminate the "in connection with" requirement and each time Congress has declined to do so. *See, e.g., Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). As *Blue Chip Stamps* notes, the SEC made two attempts in the 1950s to expand the language of Section 10(b) to include fraud in connection with "any attempt to purchase or seli" securities, not just in connection with actual purchases or sales. *Blue Chip Stamps*, 421 U.S. at 732. The SEC's attempts were rejected by Congress, which did not want to expand civil liability under Section 10(b). *Id.*

Since Congress has not seen fit to eliminate the "in connection with" requirement, despite the SEC's requests therefor, the judicial elimination of this requirement is contrary to the long-established principle of separation of powers embodied in articles I (legislative), II (executive) and III (judicial) of the Constitution. Separation of powers ensures the ability of each branch to be vigorous in asserting its proper authority. *See, e.g., Clinton v. City of New York*, 524 U.S. 417, 450 (1998) (Kennedy J., concurring). The Constitution has assigned Congress the function of enacting laws. United States Const. Art. I. The judiciary is assigned the role of adjudicating cases and controversies arising in the application of the law. United States Const. Art. III.

In keeping with the separation of powers doctrine, the judicial branch is "not authorized to rewrite a statute because [it] might deem its effects susceptible to improvement." *Badaracco v. C.I.R.*, 464 U.S. 384, 398 (1984). It is plain that the district court and the First Circuit believed that expanding the authority of the SEC by ignoring the "in connection with" requirement in this case would facilitate the SEC's efforts to protect investors by enabling the SEC to pursue common law fraud claims. However, this Court has previously held that the remedial purpose of the Securities Act (or any act) does not justify reading a provision "more broadly than its language and the statutory scheme reasonably permit." *SEC v. Sloan*, 436 U.S. 103, 116 (1978). Instead, "[t]he ultimate question [for the Court] is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law." *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979).

Here, as even the factual recitations by the district court decision and the First Circuit opinion make clear, there is nothing that Petitioners did that satisfied the "in connection with" requirement. The injunction and asset freeze order could not have been entered against them and affirmed absent judicial legislation, rewriting the anti-fraud provisions of the securities laws to expand the SEC's authority beyond that actually contained in the law. In so doing, the courts below violated the separation of powers doctrine, moving the courts into the sphere reserved for Congress.

The law as it is written, not as construed and enforced by the district court and the First Circuit, requires that there have been a misrepresentation made by a defendant in

connection with the purchase or sale of securities.[5] As the court stated in *Bailey v. Piper, Jaffray & Hopwood, Inc.*, 414 F. Supp. 475, 482-83 (D. Minn. 1976):

> Fraud, no matter how heinous, is not cognizable under Rule 10b-5 unless it is attendant upon the purchase or sale of securities. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975).

The meaning of the "in connection with" requirement too has been clearly identified by the courts. There must be a "causal relationship between the alleged deception and some consequent purchase or sale." *Liberty Nat'l Ins. Holding Co. v. Charter Co.*, 734 F.2d 545, 555 (11th Cir. 1984); *Rogen v. Ilikon Corp.*, 361 F.2d 260, 266-68 (1st Cir. 1966). As the Supreme Court held in *Blue Chip Stamps*, there must be a purchase or sale of a security that is connected with a challenged statement. 421 U.S. 723. In other words, if there is no investment made as a result of the alleged fraud, there is no securities law violation. If the investment is made before there is any alleged fraud, there is no securities law violation.

The notion of the nexus required between the alleged misrepresentation and the purchase or sale of securities has also been viewed in terms of materiality. In *SEC v. National Student Mktg. Corp.*, 457 F. Supp. 682, 702 (D.D.C. 1978), the court held that the misrepresentation or omission must

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5. The alternative formulation, that there is an omission that causes the representations made to be materially misleading, also requires either that the defendant have made representations or that the defendant have a duty to correct a representation made by another. *Gray v. First Winthrop Corp.*, 776 F. Supp. 504, 510 (N.D. Cal. 1991). These requirements too were not even remotely satisfied here.

take place in a context in which it assumes actual importance in the deliberation of an investor. Citing *TSC Indus. Inc. v. Northway, Inc.* 426 U.S. 438, 449 (1976), the court held that this means that the statements must have taken place before the sale.

Consistent with this interpretation of the "in connection with" requirement, the court in *Konstantinakos v. F.D.I.C.*, 719 F. Supp. 35, 37 (D. Mass. 1989) held that statements issued in 1988 could not have been "in connection with" a stock purchase that occurred in 1987. Further, even materially false statements that are not pertaining to the securities themselves do not satisfy the "in connection with" requirement. *McCoy v. Goldberg*, 748 F. Supp. 146, 150 (S.D.N.Y. 1990); *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 943 (2d Cir.), *cert. denied*, 469 U.S. 884 (1984). This is consistent with Congress's determination to limit the SEC's anti-fraud jurisdiction under the securities laws. It is not all alleged financial fraud that is remediable by the SEC. It is only alleged fraud that occurs in connection with the purchase or sale of securities. But that does not leave an aggrieved investor without remedy. State common law fraud provides investors with an alternative cause of action where the "in connection with" requirement has not been satisfied.

In *Haft v. Eastland Financial Corp.*, 772 F. Supp. 1315, 1317 (D.R.I. 1991), relying on *Konstantinakos*, *supra*, the court dismissed the claims because all of the alleged misrepresentations were made after the purchase of the securities in question. In this case the SEC has admitted that neither Fife nor Khan made any representations to any investors in connection with either their purchase or sale of any securities and the district court decision reflects this admission. As the district court decision acknowledges, the

only alleged communications made by either Fife or Khan occurred well after the last investment involved in this case occurred. Pet. App. 62a-64a. As the court held in *Adair v. Sorenson*, 134 F.R.D. 13, 16 (D. Mass. 1991), a party cannot be said to have relied upon events that occurred after he bought his investment. This is just another way of saying that the "in connection with" requirement cannot be satisfied by a post-investment communication.

This Court did not alter this well-settled interpretation of the "in connection with" requirement in *Zandford*. To the contrary, this Court merely recognized that the court of appeals had erred in applying applicable precedent. This Court found that since Zandford had a present intent to convert his clients' funds at the time he solicited their investment, Zandford had made a misrepresentation when he solicited the funds (i.e., not telling his clients that he intended to convert their funds). *Zandford*, 122 S. Ct. at 1904-05. Here however, Petitioners did not solicit the funds invested in Brite. Petitioners never even had any contact with any investors until well after their investment decisions and investments had been made. Petitioners had no participation whatsoever in the investment decisions being made by investors; they did not even know who the investors were or what their investment contracts provided. Accordingly, the *Zandford* ruling is inapposite to this matter.

The lower courts' decisions are understandable in the sense that there was a securities law fraud that took place in this case. Investors had been gulled into giving millions of dollars to Brite based on representations made by Clarke, Hertzog, Herula and Wachtel of astronomical returns.[6] The problem, however, is that

6. In fact, millions of dollars never even reached Brite's accounts, having been diverted by Clarke and Hertzog. Other millions (Cont'd)

the district court failed to differentiate between defendants who defrauded investors "in connection with" their purchase of the investment contracts issued by Brite and those, like Petitioners, whose conduct, whether actionable under common law or not, occurred subsequent to the investments having been made.

While the district court's decision contains broad findings of "misrepresentations," nowhere is there any identification of a single misrepresentation by Fife or Khan that was made to a purchaser or seller of any securities in connection with the purchase or sale decision. On the contrary, the district court's findings establish the exact opposite: that all of the alleged misrepresentations identified by the district court that were attributed to Fife or Khan were made after and hence, not "in connection with" the purchase or sale of securities.

As the district court acknowledged, the first communication involving Fife occurred, according to the money manager Curl with whom these communications allegedly took place, *two months after* Curl had already invested. Pet. App. 68a-69a. The only communications involving Khan that the district court identified are either to individuals who never invested money in response to his letters or letters that were never sent to any investors. Pet. App. 65a, 67a.

(Cont'd)

of dollars were simply stolen by Herula and Capalbo, against whom the district court has entered final judgments in excess of $18 million each. Hertzog and Clarke appear to have unilaterally determined what money went to Brite and what money they simply took for themselves.

The evidence described in the First Circuit's opinion confirms that the "in connection with" requirement was not satisfied as to Petitioners. Pet. App. 3a-10a. The First Circuit's opinion identifies Fife's "misrepresentations" as statements Fife allegedly made in the May 8, 2000 letter to Curl.[7] Pet. App. 18a. Having identified Fife's first allegedly false communication as occurring **after** the last investment had been made, the First Circuit nonetheless affirmed the issuance of an injunction and asset freeze based on an alleged violation of the securities laws. This affirmance cannot be sustained without acknowledging that the First Circuit has simply written the "in connection with" requirement out of the statutes.

In concluding that Fife's May 2000 letter was allegedly fraudulent, the First Circuit opinion stated that

> at the time the letter was written, Fife had already transferred and invested Rheaume's money without authorization. He had not been successful in his balance sheet enhancement program in the previous six months and a very great risk of loss accompanied participation in the balance sheet enhancement program. Thus, Fife's statements were misrepresentations.

Pet. App. 18a.

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7. The First Circuit obviously was aware that the May 8, 2000 letter was sent some 6 weeks after Curl had already invested and therefore could not satisfy the "in connection with" requirement. Looking for some possible connection, the First Circuit seems to suggests (without any support in the record or district court decision) that Fife may have known of the investment contract since there was language in the letter similar to the investment contract. Pet. App. 10a. However, even assuming that this were the case, it has nothing to do with the "in connection with" requirement.

While Fife disputes the First Circuit's conclusions as a factual matter (there not having been any evidence or testimony adduced at the hearing regarding this letter), these conclusions are also irrelevant to a determination of whether there was sufficient evidence of a securities law fraud here to sustain the injunction and asset freeze. Whether or not Fife may be liable to Rheaume for common law fraud has nothing to do with whether Fife violated the securities anti-fraud laws. Under applicable law, this post-investment letter, whether it was entirely accurate or entirely bogus as the First Circuit seemed to believe, had nothing to do with Rheaume's investment decision. That decision and the investment had already been made some 6 weeks before the allegedly false letter was written. Under this Court's precedents and under the clear and unequivocal language of the statutes, this letter could not have been material to any investment decision nor could these communications have been made "in connection with" the purchase or sale of securities.

Further, the First Circuit stated that "[b]oth Fife and Khan contacted Brite investors soliciting additional opportunities to invest funds without disclosing the high risks associated with the balance sheet enhancement program. These misrepresentations and omissions were material because a reasonable investor would want to know the risks involved in the balance sheet enhancement program." Pet. App. 18a. However, as confirmed by the district court decision being affirmed by the First Circuit (but noticeably missing from the First Circuit opinion), not a single penny was ever invested as a result of these communications by Fife and Khan. Pet. App. 62a-64a. Without an investment, there is no "purchase or sale of securities," and hence no securities law

violation.[8] The First Circuit's reference to misrepresentations and omissions being material is purely theoretical. Since there was no investment made, materiality to a decision not to invest is legally meaningless.

While both the district court and the First Circuit have identified a variety of actions engaged in by Fife and Khan that they consider to have been improper or even potentially fraudulent, the one thing that neither court has identified is anything that would even remotely support a securities law claim under the existing statutes. Both the district court decision and the First Circuit opinion clearly establish that neither Fife nor Khan engaged in any conduct in connection with the purchase or sale of securities by any investor. Neither Fife nor Khan had any contact with any investors until well after their investments had been completed. To the extent that Fife and Khan ever arguably solicited any investments by anyone, not a single investment was made.

Thus, absent the elimination of the "in connection with" requirement by the courts, there is no possible way that the district court decision could have been issued and there is no possible way that it could have been affirmed. The lower courts were not entitled to ignore the statutory limitations on the SEC's authority and they were not entitled to invade the province of Congress to rewrite the laws to eliminate

8. Also irrelevant to the issue of whether there was an actionable securities law fraud in this case is the lower courts' belief that Fife and Khan had misappropriated investor funds. In fact, the SEC never accused Fife or Khan of misappropriation or of lining their own pockets with investor funds. Whatever losses of funds Fife may ultimately be held responsible for causing or permitting while he supervised the Brite account, such claims are available to the investors who lost money (and are actually being pursued by Rheaume). Such claims are not available to the SEC.

this requirement. Yet, it is clear that both the district court and the First Circuit had to have done so because the "in connection with" requirement was not satisfied here. In doing so, the lower courts erred and violated the separation of powers doctrine.

II. The Grant Of Injunctive Relief In The Absence Of Any Admissible Evidence Violates Petitioners' Due Process Rights Under the Fifth Amendment

Given the urgency that often attends a preliminary injunction hearing, the rules of evidence are frequently relaxed to permit hearsay and other otherwise inadmissible evidence to be relied upon. However, what this Court has never addressed is whether a preliminary injunction and/or asset freeze can be based exclusively on inadmissible evidence. Here, the district court granted the preliminary injunction and the sweeping asset freeze sought by the SEC despite the absence of any admissible evidence. Petitioners submit that the issuance of an injunction and an asset freeze where there is no admissible proof to support it constitutes a violation of the Due Process clause of the Fifth Amendment. *See Brunnenkant v. Laird*, 360 F. Supp. 1330, 1331 (D.D.C. 1973) ("the essence of a fair and impartial adjudication consistent with the Fifth Amendment is not only a due process hearing but also a decision containing findings based on sufficient evidence"); *United States v. Noriega*, 746 F. Supp. 1541, 1545 & n.2 (S.D. Fla. 1990) (due process limitations on asset freeze); *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443, 471 (1993) (Scalia, J., concurring) ("Procedural due process also requires, I am certain, judicial review of the sufficiency of the evidence to sustain a civil jury verdict").

The imperative of legally sufficient evidence has been explored in greater depth in the criminal context, where this Court described the "normally operative sufficiency rule" that due process requires. This Court held that "the 'normally operative sufficiency rule' in question – when the prosecution submits no admissible evidence, its case will be deemed insufficient – is a bedrock requirement of due process, applicable in every criminal trial." *Carmell v. Texas*, 529 U.S. 513, 565 (2000). While the deprivation of liberty is certainly a paramount consideration under the Fifth Amendment, the deprivation of one's rights to property occasioned by an asset freeze should also trigger due process considerations. At a minimum, these considerations require that there be some bedrock of admissible evidence to support the property deprivation, even if there is also a body of supporting evidence that does not satisfy the rules of evidence.

In this case, the SEC submitted no admissible evidence. As a result, the district court's decision was based entirely on evidence that was either entirely inadmissible or which was admissible only against certain defendants and not generally against all defendants. As noted above, the only witness for the SEC with respect to Petitioners was one of its staff attorneys, Bradford Ali. Ali had no personal knowledge. All of his testimony was based upon pure hearsay or double hearsay. Ali could not authenticate a single exhibit to support the SEC's position. In fact, he admitted that many of the exhibits introduced through his testimony were actually incomplete and that he had never seen either the originals or the missing parts. Some of the documents had been e-mailed to him from people that he had never even met.[9]

9. Ali did introduce examination testimony taken by the SEC. However, the testimony of witnesses other than Petitioners could not be admissible against them. Further, their own testimony did not impact or support the district court decision.

While hearsay evidence has been allowed in preliminary injunctive proceedings in the interests of preventing irreparable harm, several circuits have held that the grant of an injunction without admissible evidence to be improper. *United States v. Nutri-Cology, Inc.*, 1991 WL 1078202, *3 (N.D. Cal. May 23, 1991) ("[r]eliance on conclusory affidavits in issuance of injunctive relief has been held an abuse of discretion or reversible error.") (citations omitted); *Atari Games Corp. v. Nintendo of America, Inc.*, 897 F.2d 1572, 1575 (Fed. Cir. 1990) ("a district court should be wary of issuing an injunction based solely upon allegations and conclusory affidavits submitted by plaintiff"); *American Passage Media Corp. v. Cass Communications, Inc.*, 750 F.2d 1470 (9th Cir. 1985) (reversing grant of preliminary injunction of alleged antitrust violations based on conclusory affidavits); *Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1092 (2d Cir. 1995) (conclusory allegations not credited when belied by specific facts). *Accord Martin v. American Equity Ins. Co.*, 185 F. Supp. 2d 162, 163 (D. Conn. 2002) ("bald assertions and conclusions of law will not suffice" to meet federal pleading standard). In this case, Ali's testimony, while live rather than in affidavit form, was essentially equivalent to a conclusory affidavit since his personal knowledge was non-existent.

A preliminary injunction should not be based solely on information and belief, but must be based on facts. *Bowles v. Montgomery Ward & Co.*, 143 F.2d 38 (7th Cir. 1944); *Haarman & Reimer Corp. v. United States*, 509 F. Supp. 1276, 1281 (1981); *Negron v. Wallace*, 436 F.2d 1139 (2d Cir.), *cert. denied*, 402 U.S. 998 (1971). "While we do not rule out the possibility that hearsay may form the basis for, or contribute to, the issuance of a preliminary injunction, the district courts have shown appropriate reluctance to issue

such orders where the moving party substantiates his side of a factual dispute on information and belief." *Marshall Durbin Farms, Inc. v. National Farmers Org., Inc.*, 446 F.2d 353, 357 (5th Cir. 1971); *Brennick v. Hynes*, 471 F. Supp. 863, 869 (N.D.N.Y. 1979).

The question presented to this Court, one that Petitioners submit is of considerable importance, is to what extent can a court issue an extraordinary writ, like a preliminary injunction order or an asset freeze, without some properly admissible evidence to support such relief. Petitioners submit that the Due Process clause of the Fifth Amendment requires, at a minimum, that there be a bedrock of admissible evidence to support the issuance of such drastic remedies, particularly where such relief may effectively dictate the ultimate outcome of the matter. To the best of Petitioners' knowledge, this Court has not addressed the due process issues inherent in the relaxed evidentiary standard employed by the courts in conducting evidentiary hearings on preliminary injunctions and asset freezes. Petitioners submit that this Court should require that there be some properly admissible evidence to support the issuance of a preliminary injunction or asset freeze to assure due process considerations are satisfied.

III. The Decisions of The Lower Courts Conflict With The Investment Advisers Act

Just as the district court and First Circuit have rewritten the anti-fraud statutes of the securities laws, they have also effectively rewritten Section 202(a)(11) of the Advisers Act. The courts below have ignored the plain language of the statute as well as the SEC's own interpretive release relating to the meaning of this statute. At the heart of this section is a requirement that, to be considered an investment adviser, one

must both render investment advice and specifically be compensated for the rendition of such advice.

Under both the text of the statute and the broader interpretation provided by the SEC release addressing it,[10] Fife is not an investment adviser. Section 202(a)(11) of the Advisers Act states that "any person who, *for compensation*, engages *in the business of advising others*, either directly or through publications or writings, *as to the value of securities or as to the advisability of investing in, purchasing, or selling securities*. . . ." 15 U.S.C. § 80b-2 (a)(11) (emphasis added). The SEC release states

> 'upon all the relevant facts and circumstances . . . A determination as to whether a person providing financial planning, pension consulting, or other integrated advisory services is an investment adviser will depend upon whether such person: (1) *Provides advice, or issues reports or analyses regarding securities*; (2) is in the business of providing such services; and (3) *provides such services for compensation*.'

United States v. Elliott, 62 F.3d 1304, 1310 (11th Cir. 1995), *cert. denied*, 519 U.S. 859 (1996) (citing Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services, Investment Advisers Act Releasee No. IA-1092, 52 Fed. Reg. 38400, 38401-02 (Oct. 8, 1987)).

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10. While SEC releases are not dispositive of the law, it is instructive to note that the decisions below extended the definition of investment adviser to reach individuals who do not fall within even the SEC's own guidelines. *See United States v. Elliott*, 62 F.3d 1304, 1310 (11th Cir. 1995), *cert. denied*, 519 U.S. 859 (1996).

The SEC release interpreted a person to be "in the business" of providing advice if the person: (i) holds himself out as an investment adviser or as one who provides investment advice; (ii) receives any separate or additional compensation that represents a clearly definable charge for providing advice about securities, regardless of whether the compensation is separate from or included within overall compensation, or receives transaction-based compensation if the client . . . implements the investment advice; or (iii) on anything other than rare, isolated and non-periodic instances, provides specific investment advice.[11]

The only finding made by the district court regarding the Advisers Act claim against Fife was that, "[t]he SEC has met its burden of demonstrating that it is likely to succeed in proving that . . . Fife, as an investment advisor under the Advisers Act, also violated §§ 206(1) and §§ 206(2) of the Advisers Act." Pet. App. 78a-79a. Yet, the only mention of compensation in the court's opinion is the isolated statement that Fife "agreed to become involved with managing client funds, in return for which he would receive a commission." Pet. App. 61a.[12] Accepting this statement, it does not satisfy even the SEC's own interpretive release as there is no

11. While we presently address only the compensation aspect of the Advisers Act, it is important to note that none of these disjunctive factors apply to Fife.

12. This statement itself is actually inconsistent with the record, as even the First Circuit decision made clear. The First Circuit found that Fife "understood" that he would be able to negotiate for compensation if there were profit. Pet. App. 20a. In fact, Fife actually had said at his SEC investigatory deposition that he had at most a hope or expectation that he would be able to negotiate compensation. He had no agreement to be compensated and no understanding with anyone that he would be compensated.

identification of the rendition of investment advice and no payment for the rendition of such advice. The management of funds is not investment advice and payment for management, even assuming that to be the case, is not payment for rendering investment advice.

The First Circuit affirmed the district court decision, albeit while quietly correcting the district court's error regarding Fife's alleged right to commission. The First Circuit stated that "although Fife has not yet received compensation, he understood that he would be compensated for his efforts by a commission based on a percentage of the profits from the investments, *if successful*, pursuant to a formula to be agreed upon at a later time." Pet. App. 20a. When one examines the First Circuit statement in this regard, several things are clear: Fife had not been paid anything; Fife had no existing agreement to be paid anything; and Fife had at most "an understanding" that if there were profits, he would be able to work out an agreement in the future. This does not remotely satisfy the explicit requirements of the Advisers Act either respecting compensation or respecting the rendering of investment advice.

Thus, as an alternative basis for the issuance of a sweeping injunction order and asset freeze, the courts' reliance on the alleged violation of the Advisers Act stands on no better footing than the alleged violation of the anti-fraud provisions of the securities laws. In both instances, the courts below have effectively read explicit statutory requirements out of the statutes in order to find a violation of law that, but for the rewriting of the law, would not exist. The factual recitations set forth in the decision of the district court and the First Circuit opinion make it clear that Fife's actions were not in violation of the Advisers Act. As such,

the lower courts have misapplied applicable statutory law and engaged in judicial legislation, in violation of the separation of powers doctrine. Petitioner Fife, who is the only person charged with violating the Advisers Act, respectfully submits that this Court should grant certiorari in order to correct the manifest errors committed below.

CONCLUSION

For all of the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT DATED NOVEMBER 6, 2002

UNITED STATES COURT OF APPEALS
For the First Circuit

No. 02-1640

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff, Appellee,

v.

MARTIN D. FIFE and FAROUK KHAN,

Defendants, Appellants.

DENNIS S. HERULA, MARY LEE CAPALBO (AKA MARY LEE CAPALBO HERULA), SEAVIEW DEVELOPMENT & HOLDINGS, LTD., MICHAEL CLARKE, ROBERT WACHTEL, JOHAN HERTZOG, and CHARLES SULLIVAN,

Defendants,

and

DAVID ULLOM,

Relief-Defendant.

Appendix A

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF RHODE ISLAND
[Hon. Mary M. Lisi, *U.S. District Judge*]

Before
Torruella, *Circuit Judge*,
B. Fletcher,* *Senior Circuit Judge*,
and Stahl, *Senior Circuit Judge*.

November 6, 2002

B. FLETCHER, *Senior Circuit Judge.* Defendants-Appellants Martin D. Fife ("Fife") and Farouk Khan ("Khan") appeal the district court's order granting a preliminary injunction prohibiting further violations of securities law and a freeze against defendants-appellants' assets and other assets in defendants-appellants' possession. They contend that the district court erred and abused its discretion in finding that the Securities and Exchange Commission ("SEC") established a substantial likelihood of success in proving that defendants-appellants violated the anti-fraud provisions of the federal securities laws. We have jurisdiction pursuant to 28 U.S.C. § 1292. For the reasons stated below, we affirm the preliminary injunction and asset freeze against Fife and Khan.

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* Hon. Betty B. Fletcher, of the Ninth Circuit, sitting by designation.

Appendix A

I. FACTS AND PROCEDURAL BACKGROUND

This case arises from the alleged misappropriation of investor funds and the alleged fraudulent offering of securities in connection with an investment program operated by Fife through the entities Brite Business S.A., Brite Business Corporation and Seaview Development and Holdings, Ltd. ("Seaview").

A. The Investors

During 1999 and 2000, Michael A. Clarke ("Clarke") raised approximately $51.75 million from five investors under Brite Business, S.A. and later through Brite Business Corporation. Clarke promised extraordinary returns, such as generating a $20 million dollar profit in the first twelve banking days. The five investors, with the corresponding amounts invested, are: (1) William Britt, a U.S. citizen who invested through his entity, Beehive International, LLC ($10 Million); (2) Four Star Financial Services, LLC, a U.S. entity ($11.75 million); (3) Robert Burr, a U.S. citizen who invested through his entity, Trigon Capital ($10 million); (4) Rashad Mohamed Mahran Al Bloushi ("Al Bloushi"), an individual from the United Arab Emirates ($7.5 million); and (5) Rheaume Holdings, Ltd. ("Rheaume"), a British Virgin Islands entity ($12.5 million). Another investor, Malcolm Monlezun ("Monlezun"), invested $1 million in November of 2000.

Appendix A

B. Fife's Involvement

Fife agreed to manage and invest Brite Business funds, in return for which he would receive a commission. In the SEC investigation, Fife testified that his duties were to "administer the bank accounts that [he] had signatory power over and to develop a balance sheet enhancement program with leverage[d] funds sent in to be used for financial projects."[1] Fife's balance sheet enhancement program involved pooling investors' money and then leveraging the money by purchasing treasury bills in order to qualify for third world development projects. The profits from the investment in the third world development projects would then be distributed to the investors. Fife claimed that investors would make returns of between 30 and 100 percent per year. These returns, however, were not guaranteed because of risks involved.

In October 1999, Fife established a brokerage account at the Rhode Island branch office of Raymond James Financial Services, Inc. ("Raymond James"), a securities broker-dealer, in the name of Brite Corp. Fife was the signatory on the account, and Fife's acquaintance, Dennis S. Herula ("Herula"), was the designated registered representative. Approximately $44.5 million of the $51.75 million raised for Brite Corp. was deposited into this account.[2]

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1. The SEC formally initiated an investigation entitled *In the Matter of Brite Business Corporation* on December 21, 2001. The investigation included conducting sworn investigative depositions. After several of these investigative depositions, the SEC filed the present case in federal district court.

2. The following deposits were made into the Brite account at Raymond James: (1) In October 1999, $7.5 million of investor funds

(Cont'd)

Appendix A

Mary Lee Capalbo ("Capalbo"), an attorney and the wife of Herula, established a separate brokerage account at Raymond James entitled the "Mary Lee Capalbo Esq. Special Client Account" ("Capalbo Account"). Capalbo was the signatory on this account. Fife transferred $15.5 million from the Brite account at Raymond James into the Capalbo Account at Raymond James. These transfers occurred through five transactions between April 2000 and September 2000.[3] After these transfers, $29 million remained in the Brite Account at Raymond James under Fife's supervision.

Of the $29 million remaining in the Brite account at Raymond James, $27.3 million was returned to investors.[4]

(Cont'd)

from Al Bloushi; (2) In December 1999, $10 million of investor funds from Beehive; (3) In March 2000, $7 million of investor funds from Four Star; (4) In March 2000, $10 million of investor funds from Trigon; and (5) In March 2000, $12.5 million of investor funds from Rheaume.

3. The date of the transfers with the corresponding amounts are as follows: (1) March 31, 2000: $5.5 million; (2) April 6, 2000: $4.5 million; (3) April 14, 2000: $4.5 million; (4) August 4, 2000: $972,318; and (5) September 18, 2000: $11,201.

4. The following amounts were returned/paid to investors: (1) Beehive received $10.1 million on its $10 million investment; (2) Four Star received $7 million of its $7 million investment from the Brite Account at Raymond James and then an additional $1.5 million interest payment from the Capalbo account at Raymond James; (3) Trigon received $10,000,095 on its $10 million investment; (4) Al Bloushi received $200,000 of his $7.5 million investment from the Capalbo Account at Raymond James; (5) Rheaume received $4,500 of its $12.5 million investment; and (6) Monlezun received $125,000 of his $1 million investment.

Approximately $20.5 million in principal plus promised return allegedly has been lost. Al Bloushi has received only $200,000 of his $5 million investment, and Rheaume has received only $4,500 from its $12.5 million investment.[5] As of September 18, 2000, all of the investment money under Fife's control in the Brite Account at Raymond James had been transferred out. The money deposited in the Capalbo Account was used to purchase shares in a money market mutual fund. An additional investor, Monlezun, invested $1 million raising the total amount of investor funds in the Capalbo Account at Raymond James to $16.5 million.[6] Monlezun received only $125,000 from his $1 million investment.

From June 2000 to November 2000, $8 million of Brite investor funds was paid to various entities including Seaview[7], Tamini[8], Sullivan[9], Puffin[10], Brite, Commonwealth, Four

5. According to the Raymond James account statement for Monlezun, one million dollars was transferred out of that account in November 2000.

6. This investment was transferred into the Capalbo account at Raymond James in November 2000.

7. From January 2000 to September 2001, Fife loaned Khan, on behalf of Seaview, $195,000. This loan has not been repaid.

8. In June 2000, Fife paid the Tamini Group $2.245 million for initial fees for an enhancement program. The program was not successful, and the money was lost.

9. In June 2000, Fife loaned Sullivan $350,000 of investors' money for personal needs. This loan was not repaid.

10. In August 2000, Fife paid Puffin $2 million for initial fees for an enhancement program. Puffin was a fraud and the money was lost.

Star[11], and Al Bloushi. Additional transfers in the amount of $8.6 million were made to the Mary Lee Capalbo "Special Client Account" at Citizens Bank.

C. Rheaume Agreement

Brite entered into an agreement in March 2000 with Rheaume Holdings ("Agreement"). The Agreement stated that " 'Brite' will attempt to pay benefits on a best efforts basis at a minimum average over a 90 day period of 10% per week of the amount invested." According to the Agreement, the first payment should have occurred twelve international banking days from the receipt of Rheaume's deposit by Raymond James.

On May 8, 2000, Fife wrote a letter to Rheaume ensuring "the safety, security, monitoring and auditing of our client funds is and always will be my primary function. So without hesitation I state to you that absolutely your deposit is safe, secure, unencumbered, will not be invested without your authorization, can not be moved, or withdrawn without your approval." With regard to the enhancement program, Fife stated, "I myself have been successful for the past six months doing the same placement of funds." The letter further represented that there would be "no risk of loss" and that Rheaume would receive benefits from its investment in the next two weeks.

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11. In addition, Four Star received an additional $1.5 million interest payment from the Capalbo Account at Raymond James.

Appendix A

Almost immediately after Rheaume's investment was in Fife's control, Fife began transferring funds from the Brite Account at Raymond James into the Capalbo Account at Raymond James. These funds were transferred without Rheaume's knowledge or authorization. The funds in the Capalbo Account were invested in securities without Rheaume's knowledge or authorization, and funds in the Capalbo Account were thereafter transferred into another Capalbo Account at Citizen's Bank without Rheaume's knowledge or authorization. Moreover, Fife no longer had direct control over the investments since he was not a signatory on the accounts.

In July 2000, Robert Curl ("Curl"), Rheaume's representative, requested a report of the balance in Rheaume's account. Fife forwarded letters from Herula to Curl on Raymond James letterhead reporting Rheaume's investment plus accrued interest in the Brite Account at Raymond James. However, these reports were false since the funds in the Brite Account were nearly depleted. After several months, Curl requested the return of Rheaume's funds. Fife told Curl that the money could not be returned because Raymond James worried about large sums of cash coming in and going out of an account in a short period of time. This statement was false.

A few months later, Fife suggested to Rheaume that it transfer its $12.5 million investment plus accrued interest in the Brite Account at Raymond James to an account at Charles Schwab in order to facilitate a "swift return." In December 2000, Fife advised Curl that the money was transferred to a Capalbo Account at Charles Schwab. Charles Schwab account statements were forwarded to Rheaume by Fife.

Appendix A

Throughout 2001, Fife, Herula, and Capalbo sent Curl forged Charles Schwab account statements showing upwards of $59 million in the account. Curl was told that Rheaume's investment plus accrued interest was now pooled with other investor funds in the Capalbo Account at Charles Schwab, and these funds would eventually be transferred to Fife's trading program at Seaview. These funds, however, were never moved to Charles Schwab.[12]

After these funds were allegedly placed in the Charles Schwab account, Curl again requested the return of Rheaume's funds. Fife then advised Curl that the National Association of Securities Dealers ("NASD") had frozen the account. The NASD, however, never froze this account. Fife offered to use Rheaume's money in other finance deals once the NASD released the money in the Charles Schwab Account. Fife stated that he would be able to use Rheaume's money to generate excellent returns on other project finance deals.

D. Seaview

Khan and Fife were business partners in Seaview. Seaview was loaned $195,000 of Brite's investor money from Fife. Seaview's start-up costs were obtained from Brite. When Brite dissolved, Brite's money was moved into an account at Seaview. Seaview offered the same type of balance sheet enhancement program that Fife envisioned for Brite's investors.

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12. In 2001, Rheaume's money had already been moved at least twice without authorization. Moreover, there was no activity in the Capalbo Account at Charles Schwab from January 2001 to April 2001.

Appendix A

E. Khan's Involvement

Khan engages in project financing and project development work. As Fife's partner at Seaview, Khan engaged in various tasks on behalf of the entity. Khan wrote a letter to Herula describing the "investment program" regarding the leveraging of monies. Once leveraged through balance sheet enhancement, the money would be used towards project finance. Khan signed several letters directed to potential investors in the balance sheet enhancement program. The SEC claims that these letters were intentionally aimed to mislead potential investors. There is no proof that these letters were mailed; however, a similar proposal was mailed to Al Bloushi, one of Brite's investors.

In December 2001, Khan sent letters to Al Bloushi and his representative in an attempt to convince Al Bloushi to invest additional funds in the amount of $100 million dollars in a private placement project finance program. One letter promised that Al Bloushi would receive a guaranteed return of 7% per year, *without any risk.* In addition, Al Bloushi would receive a reward for holding the investment for a year and a day. This reward included a 20% return on the 30th day of the trading cycle and an 80% return on the investment that was to be paid in four installments of 20% each.

In the SEC investigation, Khan testified that he told Al Bloushi's representative that if an investment were made, he was *guaranteed* a return. This representation was material since project finance is very risky. If a project finance investment fails, then the investor receives nothing. Khan testified that "[t]he risks are high, the rewards are high. There's a

risk/reward relationship on every, every transaction. There's tremendous amount of risks involved: there's tremendous amount of rewards to be made. The investor has to be a sophisticated investor." Although Khan testified that he informs investors of the risks of project finance, these risks were not included in the project proposal sent to Al Bloushi.

F. Procedural Background

The SEC filed this action alleging that nine defendants, including appellants Fife and Khan, violated section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and SEC Rule 10b-5 promulgated thereunder, 17 C.F.R. 240.10b-5; section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a); and, as against Fife individually, section 206 of the Investment Advisers Act, 15 U.S.C. § 80b; requesting disgorgement of the defendants' "ill-gotten gains"; and requesting the imposition of a civil monetary penalty.[13] The SEC requested an *ex parte* preliminary injunction to prohibit defendants from further violations of the federal

13. The Defendants include the following individuals: Michael Clarke, founder of Brite Business, S.A., a British Virgin Islands Corporation; Charles W. Sullivan, incorporated Brite Business Corporation in Delaware in 1999; Johan C. Hertzog, represented to clients that returns on investments would be extraordinary; Robert M. Wachtel, the U.S. representative of Brite Business, solicited Brite Business investor Rheaume; Martin Fife, identified himself as President of Brite Business Corporation and managed investor funds; Khan; Dennis S. Herula, a registered representative at Raymond James from August 1999 until January 2001; Seaview Development and Holdings, Ltd., a private business incorporated by Fife and Khan to administer balance sheet enhancement programs; and Mary Lee Capalbo, Herula's wife, the attorney in control of Brite investor funds.

securities laws as alleged in the complaint, and an order freezing defendants' assets and other assets in defendants' possession, as well as $190,000 held by relief defendant David L. Ullom.[14] The district court granted the preliminary injunction and asset freeze as to defendants Herula, Capalbo, Fife, Khan, and Seaview. The court found that Fife and Khan were the alter egos of Seaview. This appeal ensued.

II. STANDARD OF REVIEW

We review the grant or denial of a preliminary injunction for abuse of discretion; legal issues are reviewed *de novo*, and findings of fact are reviewed for clear error. *Lanier Prof'l Servs. v. Ricci*, 192 F.3d 1, 3 (1st Cir. 1999).

III. DISCUSSION

The SEC has authority under the Securities Exchange Act to bring an action in district court to enjoin individuals from engaging "in acts or practices constituting a violation of any provision" of the securities laws. 15 U.S.C. § 78u(d). In *Aaron v. SEC*, 446 U.S. 680 (1980), the Supreme Court stated that the district court shall grant such an injunction "upon a proper showing." *Id.* at 689. The requisite elements of "a proper showing" include, "at a minimum, proof that a person is engaged in or is about to engage in a substantive violation of either one of the Acts or of the regulations promulgated thereunder." *Id.* at 700-01.

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14. Ullom acquired Brite Business investor funds in return for no services being performed.

In this circuit, a preliminary injunction may be granted if the movant shows a likelihood of success on the merits, a risk of irreparable harm, a favorable balance of equities, and that the injunction would be in the public interest. *Langlois v. Abington Hous. Auth.*, 207 F.3d 43, 47 (1st Cir. 2000). The "*sine qua non*" of a preliminary injunction analysis is whether the plaintiff is likely to succeed on the merits of its claim. *Weaver v. Henderson*, 984 F.2d 11, 12 (1st Cir. 1993).

In the instant case, the district court applied the criteria mandated by the Second Circuit in SEC preliminary injunction actions, *see SEC v. Unifund SAL*, 910 F.2d 1028, 1036-37 (2nd Cir. 1990), and failed to consider the risk of irreparable harm. Unlike the Second Circuit, we require consideration of irreparable harm in actions initiated by the SEC. *SEC v. World Radio Mission*, 544 F.2d 535, 541-42 (1st Cir. 1976) (finding that the district court properly considered the "balance of the harms which would result from the grant or denial of preliminary relief," but failed to pursue plaintiff's chances of ultimate success); *see also SEC v. Lehman Brothers, Inc.*, 157 F.3d 2, 9 (1st Cir. 1998) (finding that there was no obvious harm in allowing appellant lienholder to maintain the escrow allegedly secured by debtor through unlawful insider trading). Although the district court failed to consider irreparable harm in granting the preliminary injunction, the essential requirement—finding that the SEC is likely to succeed on the merits of its claim—was met. *Weaver*, 984 F.2d at 12; *Aaron*, 446 U.S. at 700-01. The district court found that "Fife misrepresented the nature of the investment program, its overall risk, and the status of funds after they were placed" with Brite, and that the SEC established that

Khan engaged in a course of business that would operate as a fraud or deceit upon the purchaser. Moreover, "[t]he district court's amply supported finding of the likelihood that future violations would occur would ordinarily, without more, entitle plaintiff to a preliminary injunction." *World Radio Mission*, 544 F.2d at 541. The district court here found that the SEC would likely succeed in showing such future violations because of the nature of Fife and Khan's occupations, their claims of ignorance as to the scheme, the misappropriation of large amounts of investor funds, the recency of their alleged conduct, and the continuing existence of the accounts and entities used to perpetrate the alleged scheme in this case.

We may affirm the district court's grant of a preliminary injunction and asset freeze on any grounds supported by the record. *Aldridge v. A.T. Cross Corp.*, 284 F.3d 72, 84 (1st Cir. 2002) (quoting *Greenless v. Almond*, 277 F.3d 601, 605 (1st Cir. 2002)). The record sufficiently establishes "the harm caused plaintiff without the injunction, *in light of* the plaintiff's likelihood of eventual success on the merits, outweighs the harm the injunction will cause [appellants]." *Vargas-Figueroa v. Saldana*, 826 F.2d 160, 162 (1st Cir. 1987) (emphasis in original); *accord Commonwealth of Massachusetts v. Watt*, 716 F.2d 946, 953 (1st Cir. 1983); *cf. World Radio Mission*, 544 F.2d at 541 ("To the extent that a defendant can show harm, this must be discounted by the degree that a plaintiff can show likelihood of success."). Accordingly, we must affirm the preliminary injunction and asset freeze unless the district court abused its discretion.

Appendix A

A. Requirements and Evidence of Violations of the Anti-Fraud Provisions of the Securities Laws

Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), in relevant part, provides:

> It shall be unlawful for any person in the offer or sale of any securities . . . by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> > (1) to employ any device, scheme, or artifice to defraud, or
> >
> > (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
> >
> > (3) to engage in any transportation, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Id. Under section 17(a) of the Securities Act, "[s]pecific reliance by the investor need not be shown." *United States v. Ashdown*, 509 F.2d 793, 799 (5th Cir. 1975). Negligence is sufficient to establish liability under section 17(a)(2). *Aaron*, 446 U.S. at 695-697.

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Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), makes it "unlawful for any person, directly or indirectly, . . . to use . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." *Id.* The SEC promulgated Rule 10b-5 under the Securities Exchange Act, 15 U.S.C. § 78j(b). Pursuant to this rule, it shall be unlawful for any person:

> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. 240.10b-5. A statement is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether or not to invest his money in a particular security. *See Basic v. Levinson*, 485 U.S. 224, 231-232 (1988).

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Under section 10(b) and rule 10b-5, the defendants must act with scienter. Scienter is "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). The plaintiff must demonstrate that the defendants acted with a high degree of recklessness or consciously intended to defraud. *Aldridge*, 284 F.3d at 82. Recklessness is "a highly unreasonable omission, involving not merely simple, or even inexcusable [ ] negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious the actor must have been aware of it." *Greebel v. FTP Software*, 194 F.3d 185, 198 (1st Cir. 1999) (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)).

Fife and Khan assert that they did not act with the requisite degree of scienter. This argument fails. Fife and Khan made material representations, either recklessly or with scienter, with regard to the sale and offer of securities and made misleading and false statements to investors.

During the two and a half years that Fife controlled the Raymond James account, he made only two purchases in the Brite balance sheet enhancement program; both purchases were for treasury bills, one on margin and the other for cash. Fife lost approximately $1.7 million in one of these treasury bill purchases. Fife did not use investor funds to participate in third world projects, the underlying premise of the enhancement program. Further, during Fife's control of investor funds, $20.5 million of investor funds were dissipated.

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Although Fife alleges that he never saw any investor contracts between Brite and its investors, his letter to Rheaume indicates that he was at least aware of some of the Agreement's terms by using some of the contract language in his letter such as "private placement by invitation for qualified clients" and "without putting its funds at risk." At the time the letter was written, Fife had already transferred and invested Rheaume's money without prior authorization. He had not been successful in his balance sheet enhancement program in the previous six months, and a very great risk of loss accompanied participation in the balance sheet enhancement program. Thus, Fife's statements were material misrepresentations.

Since Fife and Khan were partners engaging in balance sheet enhancement programs, they knew of the risks involved in participating in these programs, failed to inform investors of these risks, and positively represented that there was no risk. If a project did not succeed, the investor would not receive back his investment or any return on his investment principal. Instead of advising clients of these risks, they promised high returns. Both Fife and Khan contacted Brite investors soliciting additional opportunities to invest funds without disclosing the high risks associated with the balance sheet enhancement program. These misrepresentations and omissions were material because a reasonable investor would want to know the risks involved in the balance sheet enhancement program. *See Basic*, 485 U.S. at 231. Moreover, Fife repeatedly made false representations to Brite investor, Rheaume, concerning the management of its investment funds.

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The SEC made a sufficient showing that Fife and Khan made material misrepresentations in connection with the purchase or sale of securities in interstate commerce under the balance sheet enhancement program. In view of defendants' past conduct, the defendants' occupations, and their continued defense that their past conduct was blameless, we conclude that the SEC made an adequate showing that repetition of such conduct in the future is reasonably likely. Therefore, the district court's grant of a preliminary injunction as to Fife and Khan under the section 17(a) of the Securities Act and section 10(b) of the Securities Exchange Act was not an abuse of discretion.

B. Requirements and Evidence of Violations of Section 206 of the Investment Advisers Act

Section 202(a)(11) of the Investment Advisers Act defines the term "Investment adviser" as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities." 15 U.S.C. § 80b-2 (a)(11). The Investment Advisers Act prohibits fraud by those who act as investment advisers. 15 U.S.C. § 80b-1. Fife asserts that he is not an Investment Adviser under the statutory definition and therefore, could not have violated the act.

The district court found sufficient evidence to hold that the SEC met its burden of demonstrating that it is likely to succeed in proving that Fife violated sections 206(1) and 206(2) of the Investment Advisers Act. First, Fife advised Curl regarding Rheaume's investment. Second, Fife's

fraudulent conduct was in connection with the offer, purchase, or sale of securities. Fife made various transfers of Rheaume's money without prior authorization, invested money in money market accounts without prior authorization, and falsely represented the status of Rheaume's funds. The Supreme Court concluded that "Congress intended the Investment Advisers Act of 1940 to be construed like other securities legislation enacted for the purpose of avoiding frauds, not technically and restrictively, but flexibly to effectuate its remedial purposes." *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963) (internal quotation marks omitted). Third, although Fife has not yet received compensation, he understood that he would be compensated for his efforts by a commission based on a percentage of the profits from the investments, *if successful*, pursuant to a formula to be agreed upon at a later time. Therefore, the district court did not err in holding that the SEC set forth a substantial likelihood of success against Fife under the Investment Advisers Act.

C. Asset Freeze

The district court found that the order freezing the defendants' assets appropriate because of the high risk that any remaining investment funds or proceeds thereof would be further depleted without such an order. The record illuminates misrepresentations and omissions concerning the offer or sale of securities. Under these circumstances, there is simply no viable argument that an asset freeze was an abuse of discretion. *Rizek v. SEC*, 215 F.3d 157, 163 (1st Cir. 2000).

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IV. CONCLUSION

The asset freeze and preliminary injunction enjoining Fife and Khan from further violations of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) are affirmed. The preliminary injunction enjoining Fife from further violations of section 206 of the Investment Advisers Act of 1940, 15 U.S.C. § 80b is affirmed.

APPENDIX B — AMENDED PRELIMINARY INJUNCTION ORDER AND ORDER FREEZING ASSETS AND OTHER EQUITABLE RELIEF OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF RHODE ISLAND DATED DECEMBER 4, 2002

UNITED STATES DISTRICT COURT
DISTRICT OF RHODE ISLAND

Case No. CA 02-154 ML

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

DENNIS S. HERULA, MARY LEE CAPALBO (AKA MARY LEE CAPALBO HERULA), MARTIN D. FIFE, FAROUK A. KHAN, SEAVIEW DEVELOPMENT AND HOLDINGS, LTD., MICHAEL A. CLARKE, ROBERT M. WACHTEL, JOHAN C. HERTZOG, and, CHARLES W. SULLIVAN,

Defendants,

-and-

DAVID L. ULLOM,

Relief Defendant.

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AMENDED PRELIMINARY INJUNCTION ORDER AND ORDER FREEZING ASSETS AND OTHER EQUITABLE RELIEF

WHEREAS, on April 1, 2002, Plaintiff Securities and Exchange Commission ("Commission") initiated this action by filing a Complaint and Emergency Motion for a Temporary Restraining Order against defendants Dennis S. Herula ("Herula"), Mary Lee Capalbo (aka Mary Lee Capalbo Herula) ("Capalbo"), Martin D. Fife ("Fife"), Farouk Khan ("Khan") and Seaview Development & Holdings, Ltd. ("Seaview"), and Motion for Order Freezing Assets and for Other Equitable Relief against defendants Herula, Capalbo, Fife, Khan and Seaview, as well as against defendants Michael Clarke ("Clarke"), Robert Wachtel ("Wachtel"), Johan Hertzog ("Hertzog"), and relief defendant David Ullom ("Ullom") (hereinafter "Emergency Motion"), with supporting Memorandum of Law, declarations, testimony transcripts and exhibits (collectively, the "Action");

WHEREAS, on April 3, 2002, the Court, having considered the Complaint and Emergency Motion and finding that the Commission had made a proper *prima facie* showing, in support of its Emergency Motion, that: (i) defendants Herula, Capalbo, Fife, Khan and Seaview, have, directly or indirectly engaged in the violations alleged in the Complaint and Amended Complaint; (ii) there is a reasonable likelihood that these violations will be repeated; (iii) unless immediately restrained and enjoined by Order of this Court, defendants Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, Hertzog, and Ullom may dissipate, conceal or transfer from the jurisdiction of this Court assets which could be subject

to an order of disgorgement or an order to pay a civil monetary penalty in this action; and (iv) entry of a temporary restraining order against defendants Herula, Capalbo, Fife, Khan, and Seaview, order freezing assets against defendants Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel and Hertzog, and against relief defendant Ullom, and order for other equitable relief against defendants Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel and Hertzog, and against relief defendant Ullom, including an accounting, are necessary to preserve the status quo;

WHEREAS, on April 11, 2002, the Court, after hearing, entered a Modified Temporary Restraining Order against defendants Herula, Capalbo, Fife, Khan and Seaview, and Modified Order Freezing Assets and for Other Equitable Relief against defendants Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel and Hertzog, and against relief defendant Ullom;

WHEREAS, the Court, after an evidentiary hearing on the Commission's Motion for a Preliminary Injunction and for an Order Freezing Assets and for Other Equitable Relief on April 23 and 24, 2002, and the Court also having considered opposition pleadings and supporting papers filed by defendants Herula, Capalbo, Fife, Khan and Seaview, as well as the arguments presented at the conclusion of the evidentiary hearing by counsel for the Commission and counsel for defendants Herula, Capalbo, Fife, Khan and Seaview, and the Court being fully advised in the premises:

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I.

IT IS HEREBY ORDERED that Herula, Capalbo, Fife, Khan, and Seaview and each of their agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, are preliminarily enjoined from violating Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77q(a)] by, directly or indirectly, through the use of any means or instrumentalities of interstate commerce or the mails or of any facility of any national securities exchange,

(a) employing any device, scheme or artifice to defraud;

(b) obtaining any money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(c) engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser,

in the offer or sale of any securities.

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II.

IT IS HEREBY FURTHER ORDERED that Herula, Capalbo, Fife, Khan, and Seaview, and each of their agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, are preliminarily enjoined from violating Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5] by, directly or indirectly, through the use of the means or instrumentalities of interstate commerce or of the mails or of any facility of any national securities exchange,

(a) employing any device, scheme or artifice to defraud;

(b) making any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(c) engaging in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

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III.

IT IS HEREBY FURTHER ORDERED that Fife and each of his agents, servants, employees, attorneys, successors or assigns, and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, are preliminarily enjoined from violating Sections 206(1) and (2) of the Investment Advisers Act of 1940 ("Advisers Act") [15 U.S.C. §§ 80b-6(l), (2)] by, directly or indirectly, using the mails or any means or instrumentality of interstate commerce to: (a) employ any device, scheme, or artifice to defraud any client or prospective client; or (b) engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

IV.

IT IS HEREBY FURTHER ORDERED that:

A. Herula and each of his agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, shall hold and retain funds-and other assets of Herula and presently held by him, for his direct or indirect benefit, under his direct or indirect control or over which he exercises actual or apparent investment or other authority in whatever form such assets may presently exist and wherever located; including, but not limited to, such funds held in the following accounts:

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Financial or Securities Institution	Account Name	Account No. (if known)
Charles Schwab & Co.	Dennis S. Herula	3545-2629
	" "	3604-3631
	Legacy 2000 Associates	0801-0028
Citizens Bank	Legacy 2000 Associates	
	Dennis S. Herula/ Mary Lee Capalbo Herula	1196-920-2
	Dennis S. Herula/ Mary Lee Capalbo	1234-573-3
	Dennis S. Herula/ Mary Lee Capalbo	1196-971-7
FleetBoston Financial	Legacy 2000, Inc.	939553902
NetBank, Inc.	Dennis S. Herula	
Raymond James Financial Services, Inc.	Dennis S. Herula	5702-4355
	" "	7816-1784
TD Waterhouse Investor Services, Inc.	Dennis S. Herula	413-31475
	Dennis S. Herula/ Mary Lee Herula	507-76907
	Legacy 2000 Associates	507-76905
Royal Bank of Scotland	LeMc Inc.	
The Belize Bank Ltd.	Black Diamond Ltd.	502-272-2

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Washington Mutual	Dennis S. Herula/ Mary Lee Capalbo Herula	193-015485
	Dennis S. Herula/ Mary Lee Capalbo Herula	192-8315563;

and, except as provided below, shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen. Notwithstanding the foregoing and by previous Order of the Court, subject to compliance with Paragraph XVI below, defendant Herula was entitled to withdraw the sum of $60,000 from funds and sources unrelated to the fraud alleged in this Action solely for the retention of counsel to pay for legal fees and expenses associated with responding to the Commission's motion for a Preliminary Injunction.

B. Notwithstanding the provisions of Paragraph IV(A), above, defendant Herula shall be entitled to withdraw sums from funds and sources unrelated to the fraud alleged in this Action solely for the purpose of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action, incurred on or after April 23, 2002. From the date of April 23 forward, said attorneys' fees and expenses shall be billed at a maximum hourly rate of $300.00. Upon Herula's submission of an affidavit as set forth in Paragraph XVI (A) to the Commission, including identifying the particular bank or banks (or other financial institutions, entities or person) from which said attorneys' fees and expenses shall be paid, the Commission shall provide them

with a copy of this Preliminary Injunction Order and otherwise notify them that Herula shall be entitled to withdraw sums for purposes of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action, incurred on or after April 23, 2002.

C. All banks, brokerage and other financial institutions and other persons or entities which receive actual notice of this Order by personal service or otherwise, including facsimile transmissions or overnight delivery service, holding any funds or other assets in the name, for the direct or indirect benefit, or under the direct or indirect control of Herula or over which Herula exercises actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, including but not limited to all such funds held in the accounts listed in Paragraph IV(A) above, and except as provided below, shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen. Notwithstanding the foregoing, defendant Herula shall be entitled to withdraw sums from funds and sources unrelated to the fraud alleged in this Action solely for the purpose of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action incurred on or after April 23, 2002. Upon Herula's submission of an affidavit as set forth in Paragraph XVI (A) to the Commission, including identifying the particular bank or banks (or other financial institutions, entities or person) from which attorneys' fees and expenses incurred on or after April 23, 2002, shall be paid, the Commission shall provide them with a copy of this

Preliminary Injunction Order and otherwise notify them that Herula shall be entitled to withdraw sums for purposes of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action.

V.

IT IS HEREBY FURTHER ORDERED that:

A. Capalbo and each of her agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, shall hold and retain funds and other assets of Capalbo and presently held by her, for her direct or indirect benefit, under her direct or indirect control or over which she exercises actual or apparent investment or other authority in whatever form such assets may presently exist and wherever located; including, but not limited to, such funds held in the following accounts:

Financial or Securities Institution	Account Name	Account No. (if known)
Ameritrade	Mary Lee Herula	768-4121240
Charles Schwab & Co.	Mary Lee Capalbo, Esq.	1317-1585
	Mary Lee Capalbo Herula	1317-1581
	" "	3545-2627
	" "	4375-4257
Citibank (South Dakota) N.A.	Mary Lee Capalbo	227618

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Citizens Bank	Mary Lee Capalbo Special Client Account	1107-507-4
	Dennis S. Herula/ Mary Lee Capalbo Herula	1196-920-2
	Dennis S. Herula/ Mary Lee Capalbo	1234-573-3
	Dennis S. Herula/ Mary Lee Capalbo	1196-971-7
FleetBoston Financial	Mary Lee Capalbo	074-0250647
Raymond James Financial Services, Inc.	Mary Lee Capalbo, Esq. Special Client Account	4911-4444
TD Waterhouse Investor Services, Inc.	Mary Lee Capalbo	388-21106
	Dennis S. Herula/ Mary Lee Herula	507-76907
Washington Mutual	Dennis S. Herula/ Mary Lee Capalbo Herula	193-015485
	Dennis S. Herula/ Mary Lee Capalbo Herula	192-8315563
Washington Trust	Mary Lee Capalbo	2014588
Wedbush Morgan Securities	Mary Lee Capalbo	2036-3626
Zion Bank	Mary Lee Capalbo Trust Account;	

and, except as provided below, shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds of other assets; and that such funds and assets are hereby frozen. Notwithstanding the foregoing and by previous order of the Court, subject to compliance with Paragraph XVI below, defendant Capalbo was entitled to withdraw the sum of $60,000 from funds and sources unrelated to the fraud alleged in this Action solely for the retention of counsel to pay for legal fees and expenses associated with responding to the Commission's motion for a Preliminary Injunction.

B. Notwithstanding the provisions of Paragraph V(A), above, defendant Capalbo shall be entitled to withdraw sums from funds and sources unrelated to the fraud alleged in this Action solely for the purpose of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action, incurred on or after April 23, 2002. From the date of April 23 forward, said attorneys' fees shall be billed at a maximum hourly rate of $300.00. Upon Capalbo's submission of an affidavit as set forth in Paragraph XVI (A) to the Commission, including identifying the particular bank or banks (or other financial institutions, entities or person) from which said attorneys' fees and expenses shall be paid, the Commission shall provide them with a copy of this Preliminary Injunction Order and otherwise notify them that Capalbo shall be entitled to withdraw sums for purposes of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action, incurred on or after April 23, 2002.

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C. All banks, brokerage and other financial institutions and other persons or entities which receive actual notice of this Order by personal service or otherwise, including facsimile transmissions or overnight delivery service, holding any funds or other assets in the name, for the direct or indirect benefit, or under the direct or indirect control of Capalbo or over which Capalbo exercises actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, including but not limited to all such funds held in the accounts listed in Paragraph V(A) above, and except as provided below, shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen. Notwithstanding the foregoing, subject to compliance with Paragraph XVI below, defendant Capalbo shall be entitled to withdraw sums from funds and sources unrelated to the fraud alleged in this Action solely for the purpose of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action incurred on or after April 23, 2002. Upon Capalbo's submission of an affidavit as set forth in Paragraph XVI (A) to the Commission, including identifying to the Commission the particular bank or banks (or other financial institutions, entities or person) from which attorneys' fees and expenses incurred on or after April 23, 2002, shall be paid, the Commission shall provide them with a copy of this Preliminary Injunction Order and otherwise notify them that Capalbo shall be entitled to withdraw sums for purposes of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action.

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VI.

IT IS HEREBY FURTHER ORDERED that:

A. Fife and each of his agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, shall hold and retain funds and other assets of Fife and presently held by him, for his direct or indirect benefit, under his direct or indirect control or over which he exercises actual or apparent investment or other authority in whatever form such assets may presently exist and wherever located; including, but not limited to, such funds held in the following accounts:

Financial or Securities Institution	Account Name	Account No. (if known)
Atlantic Bank of New York	Martin D. Fife	0001-228803
Bank of New York	Brite Business Corp	630-0056537
Bankers Trust Company	Mondial International Partners	251121-20303
	" "	04-413-945
Chase Manhattan Bank	Martin D. Fife	003-232972
CIBC Wood Gundy	Brite Business S.A.	416-0237-20

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E*Trade	Brite Business Corp.	2001039920
Raymond James Financial Services, Inc.	Brite Business Corp.	5800-3682
	" "	5800-5252
	" "	5050-3680
SG Cowen	Brite Business Corp.	
First Union Securities	Martin D. Fife	

and, except as provided below, shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen. Notwithstanding the foregoing and by previous Order of the Court, subject to compliance with Paragraph XVI below, defendant Fife was entitled to withdraw the sum of $60,000 from funds and sources unrelated to the fraud alleged in this Action solely for the retention of counsel to pay for legal fees and expenses associated with responding to the Commission's motion for a Preliminary Injunction.

B. Notwithstanding the provisions of Paragraph VI (A), above, defendant Fife shall be entitled to withdraw sums from funds and sources unrelated to the fraud alleged in this Action solely for the purposes of a) paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action, incurred on or after April 23, 2002, and b) paying

reasonable and necessary attorneys' fees and expenses associated with the defense of *Rheaume Holdings, Ltd v. Raymond James Financial Services, Inc., et al.*, CA 02-400 ML (D. R.I.) ("the Rheaume Action"). From the date of April 23 forward, said attorneys' fees and expenses shall be billed at a maximum hourly rate of $300.00. Upon Fife's submission of an affidavit as set forth in Paragraph XVI (A) to the Commission, including identifying the particular bank or banks (or other financial institutions, entities or person) from which said attorneys' fees and expenses shall be paid, the Commission shall provide them with a copy of this Preliminary Injunction Order and otherwise notify them that Fife shall be entitled to withdraw sums for purposes of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action, incurred on or after April 23, 2002, and the Rheaume Action. Further, to the extent Fife identifies assets unrelated to the fraud alleged in this Action held by him in the form of stock, the Commission shall notify the identified bank or banks (or other financial institutions, entities, or person) at which the stock is held that Fife shall have the right to convert the stock to cash, and to then use the cash to pay said attorneys' fees and expenses, consistent with the terms of this Order.

C. All banks, brokerage and other financial institutions and other persons or entities which receive actual notice of this Order by personal service or otherwise, including facsimile transmissions or overnight delivery service, holding any funds or other assets in the name, for the direct or indirect benefit, or under the direct or indirect control of Fife or over which Fife exercises actual or apparent investment or other authority, in whatever form such assets may presently exist

and wherever located, including but not limited to all such funds held in the accounts listed in Paragraph VI (A) above, and except as provided below, shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen. Notwithstanding the foregoing, subject to compliance with Paragraph XVI below, defendant Fife shall be entitled to withdraw sums from funds and sources unrelated to the fraud alleged in this Action solely for the purposes of a) paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action, incurred on or after April 23, 2002, and b) paying reasonable and necessary attorneys' fees and expenses associated with the defense of the Rheaume Action. Upon Fife's submission of an affidavit as set forth in Paragraph XVI (A) to the Commission, including identifying to the Commission the particular bank or banks (or other financial institutions, entities or person) from which attorneys' fees and expenses incurred on or after April 23, 2002 in this Action or in the Rheaume Action shall be paid, the Commission shall provide them with a copy of this Preliminary Injunction Order and otherwise notify them that Fife shall be entitled to withdraw sums for purposes of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action and the Rheaume Action. Further, to the extent Fife identifies assets unrelated to the fraud alleged in this Action held by him in the form of stock, the Commission shall notify the identified bank or banks (or other financial institutions, entities, or person) at which the stock is held that Fife shall have the right to convert the stock to cash, and to then use the cash to pay said attorneys' fees and expenses, consistent with the terms of this Order.

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VII.

IT IS HEREBY FURTHER ORDERED that:

A. Khan and each of his agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, shall hold and retain funds and other assets of Khan and presently held by him, for his direct or indirect benefit, under his direct or indirect control or over which he exercises actual or apparent investment or other authority in whatever form such assets may presently exist and wherever located; including, but not limited to, such funds held in the following account:

Financial or Securities Institution	Account Name	Account No. (if known)
Citibank, N.A.	Farouk & Lekha Kahn	2791782;

and, except as provided below, shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen. Notwithstanding the foregoing and by previous Order of the Court, subject to compliance with Paragraph XVI below, defendant Khan was entitled to withdraw the sum of $60,000 from funds and sources unrelated to the fraud alleged in this Action solely for the

retention of counsel to pay for legal fees and expenses associated with responding to the Commission's motion for a Preliminary Injunction.

B. Notwithstanding the provisions of Paragraph VII (A), above, defendant Khan shall be entitled to withdraw sums from funds and sources unrelated to the fraud alleged in this Action solely for the purpose of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action, incurred on or after April 23, 2002. From the date of April 23 forward, said attorneys' fees and expenses shall be billed at a maximum hourly rate of $300.00. Upon Khan's submission of an affidavit as set forth in Paragraph XVI (A) to the Commission, including identifying the particular bank or banks (or other financial institutions, entities or person) from which said attorneys' fees shall be paid, the Commission shall provide them with a copy of this Preliminary Injunction Order and otherwise notify them that Khan shall be entitled to withdraw sums for purposes of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action, incurred on or after April 23, 2002.

C. All banks, brokerage and other financial institutions and other persons or entities which receive actual notice of this Order by personal service or otherwise, including facsimile transmissions or overnight delivery service, holding any funds or other assets in the name, for the direct or indirect benefit, or under the direct or indirect control of Khan or over which Khan exercises actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, including but not limited to all

such funds held in the accounts listed in Paragraph VII (A) above, and except as provided below, shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen. Notwithstanding the foregoing, subject to compliance with Paragraph XVI below, defendant Khan shall be entitled to withdraw sums from funds and sources unrelated to the fraud alleged in this Action solely for the purpose of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action incurred on or after April 23, 2002. Upon Khan's submission of an affidavit as set forth in Paragraph XVI (A) to the Commission, including identifying to the Commission the particular bank or banks (or other financial institutions, entities or person) from which attorneys' fees and expenses incurred on or after April 23, 2002, shall be paid, the Commission shall provide them with a copy of this Preliminary Injunction Order and otherwise notify them that Khan shall be entitled to withdraw sums for purposes of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action.

VIII.

IT IS HEREBY FURTHER ORDERED that:

A. Seaview and each of its agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, shall hold and

retain funds and other assets of Seaview and presently held by it, for its direct or indirect benefit, under its direct or indirect control or over which it exercises actual or apparent investment or other authority in whatever form such assets may presently exist and wherever located, including, but not limited to, such funds held in the following accounts:

Financial or Securities Institution	Account Name	Account No. (if known)
Banca Popolare Friuladria	Seaview Development & Holdings, Ltd.	63100/00
Bank of American Securities, LLC	Seaview Development & Holdings, Ltd.	610-27815
Charles Schwab & Co.	Seaview Development & Holdings, Ltd.	8005-9644
CIBC Wood Gundy	Seaview Development & Holdings, Ltd.	410-21518
Raymond James Financial Services, Inc.	Seaview Development & Holdings, Ltd. " "	5703-8258 5390-2669
Wedbush Morgan Securities	Seaview Development & Holdings, Ltd.	7387-6832;

and, except as provided below, shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other

disposal of any such funds or other assets; and that such funds and assets are hereby frozen. Notwithstanding the foregoing, subject to compliance with Paragraph XVI below, defendant Seaview shall be entitled to withdraw the sum of $60,000 from funds and sources unrelated to the fraud alleged in this Action solely for the retention of counsel to pay for legal fees and expenses associated with responding to the Commission's motion for a Preliminary Injunction. Upon Seaview's submission of an affidavit as set forth in Paragraph XVI (A) to the Commission, the Commission shall immediately send a notice to all banks, financial institutions, entities or persons upon whom it has served the original Temporary Restraining Order, providing them with a copy of this Preliminary Injunction Order and notifying them that Seaview shall be entitled to withdraw the sum of $60,000 for purposes of retaining counsel.

B. Notwithstanding the provisions of Paragraph VIII (A), above, defendant Seaview shall be entitled to withdraw sums from funds and sources unrelated to the fraud alleged in this Action solely for the purpose of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action, incurred on or after April 23, 2002. From the date of April 23 forward, said attorneys' fees shall be billed at a maximum hourly rate of $300.00. Upon Seaview's submission of an affidavit as set forth in Paragraph XVI (A) to the Commission, including identifying the particular bank or banks (or other financial institutions, entities or person) from which said attorneys' fees and expenses shall be paid, the Commission shall provide them with a copy of this Preliminary Injunction Order and otherwise notify them that Seaview shall be entitled to

withdraw sums for purposes of paying reasonable and necessary attorneys' fees and expneses associated with the defense of this Action, incurred on or after April 23, 2002.

C. All banks, brokerage and other financial institutions and other persons or entities which receive actual notice of this Order by personal service or otherwise, including facsimile transmissions or overnight delivery service, holding any funds or other assets in the name, for the direct or indirect benefit, or under the direct or indirect control of Seaview or over which Seaview exercises actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, including but not limited to all such funds held in the accounts listed in Paragraph VIII (A) above, and except as provided below, shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen. Notwithstanding the foregoing, subject to compliance with Paragraph XVI below, defendant Seaview shall be entitled to withdraw the sum of $60,000 from funds and sources unrelated to the fraud alleged in this Action solely for the retention of counsel to pay for legal fees and expenses associated with responding to the Commission's motion for a Preliminary Injunction. In addition, and also notwithstanding the foregoing, defendant Seaview shall be entitled to withdraw sums from funds and sources unrelated to the fraud alleged in this Action solely for the purpose of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action incurred on or after April 23, 2002. Upon Seaview's submission of an affidavit as set forth in Paragraph XVI (A)

to the Commission, the Commission shall immediately send a notice to all banks, financial institutions, entities or persons upon whom it has served the original Temporary Restraining Order, providing them with a copy of this Preliminary Injunction Order and notifying them that Seaview shall be entitled to withdraw the sum of $60,000 for purposes of retaining counsel. Further, upon Seaview's submission of an affidavit as set forth in Paragraph XVI (A) to the Commission, including identifying to the Commission the particular bank or banks (or other financial institutions, entities or person) from which attorneys' fees and expenses incurred on or after April 23, 2002, shall be paid, the Commission shall provide them with a copy of this Preliminary Injunction Order and otherwise notify them that Seaview shall be entitled to withdraw sums for purposes of paying reasonable and necessary attorneys' fees and expenses associated with the defense of this Action.

IX.

IT IS HEREBY FURTHER ORDERED that:

A. Clarke and each of his agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, shall hold and retain funds and other assets of Clarke and presently held by him, for his direct or indirect benefit, under his direct or indirect control or over which he exercises actual or apparent investment or other authority in whatever form such assets may presently exist and wherever located, and shall prevent

any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, disposal, or diminution in value of any such funds or other assets, which are hereby frozen.

B. All banks, brokerage and other financial institutions and other persons or entities which receive actual notice of this Order by personal service or otherwise, including facsimile transmissions or overnight delivery service, holding any funds or other assets in the name, for the direct or indirect benefit, or under the direct or indirect control of Clarke or over which Clarke exercises actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, including but not limited to all such funds held in the accounts listed in Paragraph IX(A) above, shall hold and retain within their control and prohibit the withdrawal, removal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen.

X.

IT IS HEREBY FURTHER ORDERED that:

A. Wachtel and each of his agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, shall hold and retain funds and other assets of Wachtel and presently held by him, for his direct or indirect benefit, under his direct or

indirect control or over which he exercises actual or apparent investment or other authority in whatever form such assets may presently exist and wherever located, and shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, disposal, or diminution in value of any such funds or other assets, which are hereby frozen.

B. All banks, brokerage and other financial institutions and other persons or entities which receive actual notice of this Order by personal service or otherwise, including facsimile transmissions or overnight delivery service, holding any funds or other assets in the name, for the direct or indirect benefit, or under the direct or indirect control of Wachtel or over which Wachtel exercises actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, including but not limited to all such funds held in the accounts listed in Paragraph X(A) above, shall hold and retain within their control and prohibit the withdrawal, removal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen.

XI.

IT IS HEREBY FURTHER ORDERED that:

A. Hertzog and each of his agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile

transmission or overnight delivery service, shall hold and retain funds and other assets of Hertzog and presently held by him, for his direct or indirect benefit, under his direct or indirect control or over which he exercises actual or apparent investment or other authority in whatever form such assets may presently exist and wherever located, and shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, disposal, or diminution in value of any such funds or other assets, which are hereby frozen; including, but not limited to, such funds held in the following accounts:

Financial or Securities Institution	Account Name	Account No. (if known)
J. P. Morgan Chase	Johan C. Hertzog	
J. P. Morgan Chase Investment Services	Johan C. Hertzog	

B. All banks, brokerage and other financial institutions and other persons or entities which receive actual notice of this Order by personal service or otherwise, including facsimile transmissions or overnight delivery service, holding any funds or other assets in the name, for the direct or indirect benefit, or under the direct or indirect control of Hertzog or over which Hertzog exercises actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, including but not limited to all such funds held in the accounts listed in Paragraph XI(A) above, shall hold and retain within their control and prohibit

the withdrawal, removal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets; and that such funds and assets are hereby frozen.

XII.

IT IS HEREBY FURTHER ORDERED that:

A. Ullom and each of his agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, shall hold and retain funds and other assets of Ullom and presently held by him, for his direct or indirect benefit, under his direct or indirect control or over which he exercises actual or apparent investment or other authority in whatever form such assets may presently exist and wherever located, and shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, disposal, or diminution in value of any such funds or other assets in an amount equal to $190,000, which are hereby frozen except that Defendant Ullom may expend funds unrelated to the fraud alleged in this Action that are reasonable and necessary for daily living expenses not to exceed $4,000 in a one-month period and for ordinary business expenses subject to the provisions in Paragraph XVII of this Order below.

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B. All banks, brokerage and other financial institutions and other persons or entities which receive actual notice of this Order by personal service or otherwise, including facsimile transmissions or overnight delivery service, holding any funds or other assets in the name, for the direct or indirect benefit, or under the direct or indirect control of Ullom or over which Ullom exercises actual or apparent investment or other authority, in whatever form such assets may presently exist and wherever located, shall hold and retain within their control and prohibit the withdrawal, removal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance, diminution in value, or other disposal of any such funds or other assets in an amount equal to $190,000; and that such funds and assets are hereby frozen except that Defendant Ullom may expend funds unrelated to the fraud alleged in this Action that are reasonable and necessary for daily living expenses and for ordinary business expenses subject to the provisions in Paragraph XVII of this Order below.

XIII.

IT IS HEREBY FURTHER ORDERED that all persons who hold or possess the direct or indirect proceeds of the misconduct described in the Amended Complaint, in whatever form such funds or other assets may presently exist, who receive actual notice of this Order, by personal service or otherwise, including facsimile transmission or overnight delivery service, shall hold and retain such funds and assets and shall prevent any withdrawal, sale, payment, transfer, dissipation, assignment, pledge, alienation, encumbrance,

disposal, or diminution in value of any such funds or other assets, which are hereby frozen except as provided for in Paragraphs IV through VIII.

XIV.

IT IS FURTHER ORDERED that Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, and Hertzog, their agents, servants, employees and attorneys, and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmissions or overnight delivery service, and each of them, are prohibited from accepting or depositing any monies obtained from actual or prospective United States investors pending the resolution of this action.

XV.

IT IS HEREBY FURTHER ORDERED that Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, Hertzog, and Ullom, their agents, servants, employees and attorneys, and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmissions or overnight delivery service, and each of them, shall, from the date of receiving actual notice of this Order, take such steps as are necessary to repatriate and deposit into the registry of the Court in an interest bearing account, any funds or assets that were obtained directly or indirectly from investors that presently may be located outside of the United States.

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XVI.

IT IS HEREBY FURTHER ORDERED that defendants Herula, Capalbo, Fife, Khan, and Seaview shall be allowed to use funds unrelated to the fraud alleged in this Action for reasonable and necessary attorney's fees and expenses as described in paragraphs IV, V, VI, VII and VIII, above, pursuant to the following conditions:

A. Prior to the payment of any attorneys' fees, the defendant seeking to pay attorneys' fees shall make and file a sworn affidavit asserting that the funds or other assets to be used for payment of reasonable and necessary attorneys' fees originated from sources unrelated to the fraud alleged in this Action;

B. From April 3, 2002 through April 22, 2002, the reasonable and necessary attorneys' fees that may be paid by defendant Herula from any of his assets or accounts subject to the asset freeze provided herein shall not exceed the sum of $60,000;

C. From April 3, 2002 through April 22, 2002, the reasonable and necessary attorneys' fees that may be paid by defendant Capalbo from any of her assets or accounts subject to the asset freeze provided herein shall not exceed the sum of $60,000;

D. From April 3, 2002 through April 22, 2002, the reasonable and necessary attorneys' fees that may be paid by defendants Fife, Khan and Seaview from any of their assets or accounts subject to the asset freeze provided herein shall not exceed the sum of $60,000;

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E. From April 23, 2002, forward, any reasonable and necessary attorneys' fees that may be paid by defendants Herula, Capalbo, Fife, Khan and Seaview, respectively, shall be billed at a maximum hourly rate of $300.00;

F. All bills for attorneys' fees (with appropriate redaction of privileged information) under this Paragraph shall be submitted to the Court for *in camera* review to allow the Court to determine whether the attorneys' fees are reasonable and necessary. The Court shall review the bills upon submission thereof and shall approve or disapprove the bills, or any portion thereof, within 30 days of their submission to the Court. The Court shall issue an Order providing for the payment of the bills, or any portion thereof, that are approved and, upon receipt, the Commission shall provide a copy of said Order(s) to the relevant bank or banks (or other financial institutions, entities or person) enabling the defendants to draw upon such funds for the payment of attorneys' fees and expenses. With respect to any attorneys' fees and expenses that are not, in the first instance, approved by the Court, the party affected thereby may apply to the Court for reconsideration of such fees and expenses, with such reconsideration to proceed *in camera*;

G. The Commission shall not be entitled to seek the return of attorneys' fees, paid under this Paragraph, from counsel for the Defendants' attorneys, provided the Defendants make and file the affidavit required in Paragraph XVI (A) and to the extent the Court determined that such attorney's fees were reasonable and necessary after conducting the review described in Paragraph XVI (D) above.

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XVII.

IT IS HEREBY FURTHER ORDERED that Relief Defendant Ullom shall be allowed to use funds unrelated to the fraud alleged in this Action that are reasonable and necessary to carry on the ordinary course of business, pursuant to the following conditions:

A. Relief Defendant Ullom shall make and file a sworn affidavit asserting that the funds or other assets that are reasonable and necessary to carry on the ordinary course of business originated from sources unrelated to the fraud alleged in this Action; and

B. After payment of any funds under this Paragraph, Relief Defendant Ullom shall submit to the Commission a copy of the check register evidencing such payments.

XVIII.

IT IS HEREBY FURTHER ORDERED that the Court's previous Orders requiring that defendants Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, Hertzog, and Ullom, submit an accounting shall remain in effect, and further that each defendant shall submit in writing and serve upon the Commission, upon service of this Order, an accounting identifying, to the extent that the information has not previously been provided to the Commission:

1. all transfers or payments of funds to each of them or any other entity from investors or clients in connection with the misconduct described in the Complaint (the identification

shall include the amount of each such transfer or payment, the date of the transfer or payment, and the name, address, account number and financial institution of the party making and the party receiving the transfer or payment);

2. in detail, the precise disposition of each transfer or payment identified in response to paragraph 1 above and all assets derived therefrom, including but not limited to:

a. the nature and results of any investment in which the funds were used;

b. any subsequent transfer or payment of the funds (the identification shall include the amount of each such transfer or payment, the date of the transfer or payment, the name, address, account number and financial institution of the party making and receiving the transfer or payment, and the reason for the transfer or payment); and

c. any fees or expenses charged and a detailed statement of the nature and purpose of such fees and expenses.

3. by name and address, all persons, entities and accounts currently holding funds or assets derived from the transfers or payments described in paragraph 1 above and the reason each received the funds or assets (the identification shall include the amount each received, the date received, the reason received, the institution and account number or location in which the funds or other assets are held and the

name, address, account number and financial institution of the person or entity who provided each with the funds or other assets);

4. assets of every type and description with a value of at least one thousand dollars ($2500) presently owned by or held for the direct or indirect benefit, or subject to the direct or indirect control, of the respective defendants, whether in the United States or elsewhere; and,

5. all accounts held at any bank, brokerage or other financial institution in the United States or elsewhere in the name of, for the direct or indirect benefit, or under the direct or indirect control of, Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, Hertzog, or Ullom, or in which Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, Hertzog, or Ullom has or had any direct or indirect beneficial interest, at any time since January 1, 1999.

XIX.

IT IS HEREBY FURTHER ORDERED that Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, Hertzog, and Ullom shall submit in writing to the Commission, upon service of this Order, a list of all telephone or facsimile transmission numbers (including numbers of pagers and mobile telephones), street addresses, postal box numbers, safety deposit boxes and storage facilities used by them or under their direct or indirect control, at any time since January 1, 1999 to the present. However, to the extent that Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, Hertzog, or Ullom, previously has provided the information

described above pursuant to the Temporary Restraining Order (or modified Temporary Restraining Order) entered in this Action, compliance with the requirements of this paragraph of the Order is complete.

XX.

IT IS HEREBY FURTHER ORDERED that Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, Hertzog, and Ullom, and each of his agents, servants, employees and attorneys and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, including facsimile transmission or overnight delivery service, are hereby restrained from destroying, mutilating, concealing, altering, disposing, or transferring custody of any items, including but not limited to any books, records, documents, correspondence, contracts, agreements, assignments, obligations, tape recordings, computer media or other property relating to Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, Hertzog, or Ullom, or the misconduct described in the Amended Complaint.

XXI.

IT IS HEREBY FURTHER ORDERED that Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, Hertzog, and Ullom shall serve the statements and accountings required herein on counsel for the Commission by messenger, overnight delivery service or by facsimile to Martin F. Healey, Esq., U.S. Securities and Exchange Commission, 73 Tremont Street, 6th Floor, Boston, MA 02108, or at facsimile number (617) 424-5940.

Appendix B

s/ Mary M. Lisi
UNITED STATES DISTRICT JUDGE

Dated: 12/4/02
Providence, Rhode Island

APPENDIX C — MEMORANDUM AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF RHODE ISLAND DATED MAY 1, 2002

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF RHODE ISLAND

C.A. No. 02-154ML

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

DENNIS S. HERULA, MARY LEE CAPALBO (AKA MARY LEE CAPALBO HERULA), MARTIN D. FIFE, FAROUK A. KHAN, SEAVIEW DEVELOPMENT AND HOLDINGS, LTD., MICHAEL A. CLARKE, ROBERT M. WACHTEL, JOHAN C. HERTZOG, and, CHARLES W. SULLIVAN,

Defendants,

-and-

DAVID L. ULLOM,

Relief Defendant.

MEMORANDUM AND ORDER

The Securities and Exchange Commission ("SEC") filed the above entitled action alleging that all nine defendants: Dennis S. Herula ("Herula"), Mary Lee Capalbo (a.k.a. Mary

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Lee Capalbo Herula) ("Capalbo"), Martin D. Fife ("Fife"), Farouk A. Khan ("Khan"), Seaview Development and Holdings, Ltd. ("Seaview"), Michael A. Clarke ("Clarke"), Robert M. Wachtel ("Wachtel"), Johan C. Hertzog ("Hertzog"), and Charles W. Sullivan ("Sullivan"), were involved in various aspects of a sham "investment program" that involved the fraudulent offering of securities as well as the alleged misappropriation of investor funds. This matter is before the Court on the SEC's motion for a preliminary injunction as to defendants Herula, Capalbo, Fife, Khan, and Seaview, enjoining them from committing future violations of the securities laws, and for an order freezing their assets.

I. TRAVEL OF THE CASE

On April 3, 2002, this Court granted the SEC's motion for an *ex parte* Temporary Restraining Order, enjoining defendants Herula, Capalbo, Fife, Khan, Seaview, Clarke, Wachtel, and Hertzog from violating those sections of the securities laws which they are alleged to have violated in the complaint, and, further, freezing all of their assets as well as $190,000 of monies held by relief defendant David L. Ullom ("Ullom"). The Court set a preliminary injunction hearing down for April 9, 2002. On April 9th the parties agreed to continue the hearing date for two weeks. The Court modified the asset freeze in order to allow the defendants to access funds for the purpose of retaining counsel and preparing for the preliminary injunction hearing. On April 23 and 24, 2002, this Court held an evidentiary hearing in this matter, and on April 24th the Court issued an oral decision granting the SEC's motion for a preliminary injunction and asset freeze as to

defendants Herula, Capalbo, Fife, Khan, and Seaview[1], and informed counsel that a written decision would follow. This writing sets forth a detailed explanation of that ruling.

II. FACTS

Background

A. *The Scheme is Hatched*

This matter involves the alleged misappropriation of investor funds and the alleged fraudulent offering of securities in connection with an "investment program" operated by Fife through the entities Brite Business S.A., Brite Business Corporation ("Brite Corp.") and Seaview. The alleged scheme originated with Clarke, a citizen and resident of England, who began soliciting investors through Brite Business S.A., a British Virgin Islands company, which was established in December 1997. Pursuant to that endeavor, Clarke asked an acquaintance, Hertzog, to introduce him to someone in the United States who could help Clarke establish accounts at U.S. financial institutions and manage client funds. Hertzog introduced Clarke to his acquaintance, Fife, and, by the spring of 1999, Fife had agreed to become involved with managing client funds, in return for which he would receive a commission. In or about April 1999, Hertzog arranged for another acquain-

1. During the hearing held in this matter, the SEC advised the Court that it had received a written communication from Hertzog indicating that he is aware of the pendency of these proceedings and that he intends to represent himself. Ullom agreed to continue the preliminary injunction hearing to a later date. The whereabouts of Clarke and Wachtel are unknown to the SEC.

tance of his, Sullivan, to incorporate Brite Corp. in Delaware, with its principal place of business in New York, New York. At various times between 1999 and 2001, Clarke, Hertzog, Wachtel, Sullivan, and Fife held themselves out as officers, directors and/or representatives of Brite Business S.A. and/or Brite Corp. Additionally, Fife and Kahn held themselves out as representatives of Seaview.

B. *Investor Funds are Raised*

During 1999 and 2000, the SEC alleges that Clarke, Hertzog, and Wachtel raised approximately $51 million from at least five investors, first under the auspices of Brite Business S.A., and later through Bnte Corp. Those investors, and the amounts they invested, were 1) William Britt, a U.S. citizen who invested through his entity; Beehive International LLC ("Beehive") ($10 million); 2) Four Star Financial Services, LLC, a U.S. entity ("Four Star") ($11.75 million); 3) Robert Burr, a U.S. citizen who invested through his entity, Trigon Capital ("Trigon") ($10 million); 4) Rashed Mohamed Mahran Al Bloushi, an individual who resides in the United Arab Emirates ("Al Bloushi") ($7.5 million); and 5) Robert Fitzhenry, a Canadian investor who invested through his entity, Rheaume Holdings ("Rheaume") ($12.5 million) (collectively, the "Original Investors"). In addition, a sixth investor, Malcolm Monlezun, invested $1,000,000 in November 2000 with Herula who was, at the time, a broker with Raymond James Financial Services, Inc. ("Raymond James"). Monlezun's investment was in a money market fund at Raymond James, and originally had nothing to do with Brite Corp., Seaview, or Fife. In or around February 2001, Herula informed Monlezun that he was leaving Raymond

James to become a stock broker at Charles Schwab & Co., Inc. ("Charles Schwab"). At that time, Herula solicited and received Monlezun's agreement to participate in a "European trading program" that Herula indicated was being run by Fife and that involved trading multiple clients' funds in medium term notes at a European bank.

Of the six investors from whom money was solicited, three appear to have received most or all of their funds back, and the other three have received only a small portion back. These investors have allegedly lost approximately $20.5 million in principal plus promised returns.[2]

C. *The Main Accounts*

In October 1999, Fife established a brokerage account at Raymond James' branch office in Rhode Island in the name of Brite Corp. That account was set up as the initial depository for monies that were supposedly being used in Fife's "investment program." Fife was the signatory on the account. Herula was the designated registered representative at Raymond James for the Brite Corp. account. In March 2000, Fife, Herula, and Herula's wife, Capalbo, an attorney currently in good standing with the Rhode Island Bar, established a separate brokerage account at Raymond James called the "Mary Lee Capalbo, Esq. Special Client Account." That account was established, according to Fife, because he felt that a lawyer's trust account offered "protection of the

2. Beehive, Four Star, and Trigon have received most or all of their money back. Al Bloushi has received approximately $200,000; Rheaume has received approximately $4,500; and Monlezun has received approximately $125,000.

funds at all times." At some point, another account bearing Capalbo's name was established at Charles Schwab. Beginning in 1999, approximately $44.5 million of the roughly $51 million raised by Clarke, Hertzog, and Wachtel, was deposited in the Brite Corp. account at Raymond James. Specifically, $5 million of A1 Bloushi's money was deposited in October 1999; $10 million of Beehive's funds were deposited in December 1999; $7 million of Four Star's funds, $10 Million of Trigon's funds, and $12.5 million of Rheaume's funds were deposited in March 2000. Subsequently during 2000, purportedly as part of Fife's investment program, Fife authorized and/or directed Herula and Capalbo to transfer approximately $15.5 million out of the Brite Corp. account at Raymond James and into the Capalbo account at Raymond James. From those monies, at least $8.5 million was transferred to a separate Capalbo account that had been established at Citizen's Bank. In or around September 2000, Fife moved his "investment program" from Brite Corp. to his own entity, Seaview, in which he is a partner with Khan, and the Brite Corp. account at Raymond James was closed.

D. *The "Investment Program"*

The "investment program" into which the large majority of investor funds were purportedly placed was characterized as a "credit enhancement" or "balance sheet enhancement" program that promised astronomical returns without any accompanying risk. Ostensibly, once investor funds were received by Brite Corp., Fife would leverage those pooled assets by, for example, purchasing United States Treasury Bills ("T-Bills") on margin, to enhance Brite Business's balance sheet, in order to qualify for project financing involv-

ing, for instance, Third World development projects such as housing development and fisheries projects. In theory, once financing was secured for particular projects, funds would be returned to investors, and investors would realize a return from the profits generated from the projects.

In addition to the funds being raised through Brite Business S.A. and Brite Corp., Herula had a separate arrangement with Seaview, Fife, and Khan whereby Herula was working to raise investor funds for placement into Fife's investment program. In connection with that arrangement, Capalbo's role was multifaceted. Capalbo understood that accounts housing investor funds were set up using her name and status as an attorney, she communicated with potential investors, and she was the individual who wired client funds at the behest of Fife and/or Herula. Pursuant to these endeavors, Herula and Capalbo were provided with letters discussing the investment program (now operating at Seaview), signed by both Fife and Khan on Seaview letterhead, to be used by Herula and Capalbo to solicit and/or comfort potential investors. There is no evidence that those letters were ever distributed to investors. Those letters contained several misrepresentations regarding the status of the investor program and associated risk.

Fife's investment program never progressed beyond the theoretical stage and, as a result, was wholly unsuccessful. In addition to the outright disappearance of monies collected thereunder, investor funds were also lost through interest payments due on T-Bills bought on margin. Fife never obtained bank financing for any of his projects.

Appendix C

Misrepresentations and Fraud

A. *The Al Bloushi Investment*

The agreements with the Original Investors promised extremely high rates of return and made certain other representations which proved to be false. For example, the written contracts with investor Al Bloushi signed by Clarke, on behalf of Brite Business S.A., and Al Bloushi's representative, Mohamed B. Hamad ("Hamad"), in May 1999, represented that a $7.5 million investment would be leveraged to $50 million and would then generate a $20 million profit in the first twelve banking days, $20 million more in the second twelve banking days, and $40 million each subsequent month. The contract also contained language indicating that the agreement conformed to the requirements of the U.S. Federal Reserve and the U.S. Treasury and that it involved an issuing bank that was a European "AA" or better bank. As of November 1999, the "program" had not yet begun, at which point Hertzog sent an e-mail to Hamad providing a status update on the "leverage" program, indicating that program was very close to getting started. Similarly, Sullivan sent a letter to Hamad in June of 2001, indicating that although the program had not yet gotten off the ground, Hertzog was "working 18 hour days . . . in order to advance transactions" for the purpose of honoring commitments made to Al Bloushi by Clarke. Sullivan estimated that profits would be distributed "within the next 60 to 90 days" and promised an extra 20% bonus "for your long patience." Finally, on December 12, 2001, around the same time the SEC had begun investigating the individuals and entities involved in this scheme, Sullivan sent a letter to Al Bloushi advising him that he was about to

be paid 100% of promised profits plus principal beginning on December 31, 2001, with the final payment being made on February 28, 2002. All of these representations turned out to be false, and, save an "interest payment" of approximately $200,000, Al Bloushi has not received the return of his $7.5 million investment, and those funds appear to have been transferred out of the Raymond James' accounts and converted by Herula, Fife, Capalbo and Khan.

Evidencing a continuing pattern of intentional misrepresentation, in December 2001, long after all of the above listed investors had begun to demand, or had actually received, the return of their money, Khan, Fife's partner at Seaview, attempted to convince Al Bloushi through his representative, Hamad, to invest additional funds in an "investment program." Khan did not indicate that the program was associated with Fife or Seaview, but described a program similar to the programs described by the others as being run by Fife. Khan's written proposal to Al Bloushi's representative, Hamad, promised that investor funds would be invested with a "AA" rated West European Bank, and guaranteed a return of 7% per year, without any accompanying risk. On top of that guaranteed return, the investor was promised to receive a "reward" for holding the investment to the maturity date (one year and one day). On a $100 million investment, the investor would receive a 20% return on the 30th day of the "Trading Cycle," and would then receive an additional 80% return in four installments of 20% each, over the following eleven months. Khan represented that the "offer was only available during the month of December 2001 so as to take advantage of the Bank's inventory in its portfolio prior to year end." That agreement was never consummated.

Appendix C

B. *The Rheaume Investment*

The events involving the solicitation and eventual entry into an agreement with Rheaume were similarly mired in deception. Wachtel solicited Rheaume, a British Virgin Islands entity, through its money manager, Robert Curl ("Curl"), some time in early 2000. After describing an investment opportunity involving a "credit enhancement" program that would be run by Brite Corp., Wachtel referred Curl to Herula for the purpose of opening an account for the investment. At some point during the first quarter of 2000, Curl met with Herula at the Cranston, Rhode Island branch office of Raymond James, where Herula was employed as a stock broker. Herula represented that: 1) the principal invested would be segregated in an account in Rheaume's name; 2) Rheaume's funds would be invested by Brite Corp. in T-bills; and 3) the funds would be free from risk, would not be withdrawn without the client's authorization, and would be protected from creditors. On March 23, 2000, based, according to Curl, in large part on representations made to Curl by Herula, Rheaume executed an agreement with Brite Corp. that was signed by Clarke as its vice president, by Wachtel as the "USA Mandated Representative" of Brite Corp, and by Robert Fitzhenry, the President of Rheaume. The contract stated that Brite Corp. would "attempt to pay benefits on a best effort efforts basis at a minimum average over a 90 day period of 10% per week of the amount invested." And, further, that the first payment would be made "12 international banking days from the receipt of Rheaume's deposit by Raymond James." Fife, who held himself out as the manager of the funds Rheaume invested at Raymond James, represented to Curl and Fitzhenry, in a letter dated

May 8, 2000, that: 1) his primary function was to ensure "the safety, security, monitoring and auditing" of client funds; and 2) the Rheaume funds were "absolutely . . . safe, secure, unencumbered, will not be invested without your authorization, [and] can not be moved, or withdrawn without your approval." Fife further represented that "I myself have been successful for the past 6 months doing the same placement of funds," and that "[t]he moneys are safeguarded so there is no risk of loss and verification is needed daily to participate in a transaction used to finance humanitarian or World Bank, Third World projects." In addition, Fife attached a memorandum from The Dreyfus Corporation, evidencing Fife's credentials as a Director/Trustee of a number of Dreyfus Flagship Funds.[3] In fact, at the time that letter was written, Fife's credit enhancement program had not been successful, and he had lost just under $1.6 million in investor funds that went to pay the interest due on T-Bills he bought on margin. Moreover, safeguards had not been erected to ensure that Rheaume's funds were at no risk of loss.

Additionally, from late 2000 through at least February 2002, Fife, Herula, and Capalbo made a number of false and misleading statements to Curl to convince him that Rheaume's investment was still safe. Fife told Curl during 2000 that Raymond James would not release the Rheaume funds because it was concerned about large sums of money going in and out of accounts in such a short period of time. According to Curl, in December 2000, Fife told Curl that he had transferred the $12.5 million plus accrued interest to a special client account at Charles Schwab under Capalbo's name. Fife represented

3. Dreyfus is a large investment fund management company.

that this was a money market account with securities holdings. Fife told Curl that he did this to facilitate the swift return of Rheaume's funds to Curl. In fact, the $12.5 million in Rheaume funds initially held in the Brite Corp. account at Raymond James was never moved to the Capalbo account at Charles Schwab because, by this time, there were no Brite Corp. investor funds left in the account at Raymond James.

Throughout 2001, Fife, Herula, and Capalbo sent Curl forged Charles Schwab account statements showing a balance of upwards of $59 million in the account. They told him numerous times that $12.5 million of that amount (plus accrued interest) was Rheaume's investment funds, that the funds had been pooled with other investor funds in the Capalbo account at Charles Schwab, and that those funds were to be transferred to Fife's trading program at Seaview.

Herula made representations to Curl during 2001 that the Rheaume funds could not be released from the Capalbo account at Charles Schwab because the account had been frozen by the NASD (National Association of Securities Dealers). In fact, the Capalbo account at Charles Schwab was never frozen by the NASD. Herula admitted that he created false documents on Charles Schwab stationery stating that the account was frozen. Fife repeated the NASD freeze story directly to Curl numerous times in 2001 in response to Curl's requests for the return of the Rheaume funds. Save a payment of $4,500, the Rheaume funds have not been returned and appear to have been converted by Herula, Fife, Capalbo, and Khan.

Appendix C

C. *The Monlezun Investment*

Similarly, Monlezun was mislead by Herula and Capalbo. Herula guaranteed Monlezun a return of at least 10% per month with a promise that the principal would be returned within one year. Herula told Monlezun that in order to participate in the program he would have to transfer his funds from Raymond James to an escrow account at Charles Schwab that was under the control of Capalbo, whom Herula failed to identify as his wife. In addition to Herula's representations about the return Monlezun could expect on his investment, Herula and Capalbo made various representations to Monlezun regarding the status of his investment which turned out to be false. Except for approximately $125,000, Monlezun's funds have not been returned.

D. *Misappropriation*

Of the approximately $44.5 million of investor funds placed in the Fife "credit enhancement" program, approximately $27.2 million was returned to three investors, Beehive, Four Star, and Trigon, when they demanded their money back. Of the remaining funds: 1) approximately $6 million was transferred from the Capalbo account at Raymond James to a series of accounts controlled by Capalbo and/or Herula, located at Citizen's Bank and was used to pay personal credit card bills; taken in the form of ATM cash withdrawals, and used to purchase jewelry, art, antiques, real estate, and other items; 2) $4.245 million was paid by Fife to individuals who purportedly were going to assist Fife with his "investment program"; 3) $1.789 million was taken as "loans" by Fife ($1.244 million), Khan ($195,000), and Sullivan ($350,000);

and 4) over $1.6 million was lost by Fife when he purchased T-Bills on margin as part of the trading program. None of these monies appear to have been repaid.

III. DISCUSSION

In deciding whether a preliminary injunction enjoining future violations of the securities laws is warranted, the SEC must demonstrate:

> a) a *prima facie* case that a violation of the securities laws has occurred, and
>
> b) a strong likelihood that a violation will occur again in the future.

SEC v. Unifund SAL, 910 F.2d 1028, 1037 (2nd Cir. 1990) (citation omitted); *see SEC v. Cavanagh*, 155 F.3d 129, 132 (2nd Cir. 1998). "An asset freeze requires a lesser showing; the SEC must establish only that it is likely to succeed on the merits." *Cavanagh*, 155 F.3d at 132 (citing *Unifund SAL*, 910 F.2d at 1041). "Unlike a private litigant, the SEC need not show risk of irreparable injury." *Id.* (citing *Unifund SAL*, 910 F.2d at 1036). In this case, the SEC alleges that all of the defendants violated § 10(b), and rule 10b-5 promulgated thereunder, of the Securities and Exchange Act of 1933, and § 17(a) of the Securities and Exchange Act of 1934. Additionally, the SEC charges Fife with a violation of §§ 206(1) and (2) of the Advisers Act of 1940.

Appendix C

A. *Proscription on Future Securities Law Violations*

In the first instance, the SEC's burden on the merits in obtaining a preliminary injunction is no greater than the traditional "likelihood of success" standard regularly applied to private litigants. *Unifund SAL*, 910 F.2d at 1037. "'Prima facie case' has a clear meaning: evidence of an amount and quality sufficient to send a case to the trier of fact." *Id.* "[E]ven when applying the traditional standard of 'likelihood of success,' a district court, exercising its equitable discretion, should bear in mind the nature of the preliminary relief the [SEC] is seeking, and should require a more substantial showing of likelihood of success, both as to violation and risk of recurrence, whenever the relief sought is more than preservation of the status quo." *Id.* at 1039. As is the case with any litigant, the SEC should be compelled "to make a more persuasive showing of its entitlement to a preliminary injunction the more onerous the burdens of the injunction it seeks." *Id.*

In deciding whether injunctive relief proscribing future violations of federal securities laws is appropriate, the Court looks at the following factors: whether the defendant "has been found liable for illegal conduct; the degree of scienter involved; whether the infraction is an 'isolated occurrence;' whether defendant continues to maintain that his past conduct was blameless; and whether, because of his professional occupation, the defendant might be in a position where future violations could be anticipated." *Cavanagh*, 155 F.3d at 135 (citing *SEC v. Commonwealth Chem. Sec., Inc.*, 574 F.2d 90, 100 (2nd Cir. 1978)) ("*Cavanagh* factors").

Appendix C

B. *Asset Freeze*

A freeze order does not place defendants "at risk of contempt in all future securities transactions. It simply assures that any funds that may become due can be collected." *Unifund SAL*, 910 F.2d at 1041. Unlike an injunction which proscribes future trading activity on the part of the defendant, and requires the two-part showing discussed above, "an asset freeze requires a lesser showing; the SEC must establish only that it is likely to succeed on the merits." *Cavana*, 155 F.3d at 132 (citation omitted). A freeze order may be imposed so long as it orders remedial relief and is not a penalty assessment. *Id.*

"[T]he decision to order a temporary freeze on defendants' assets as ancillary relief in an SEC enforcement action requires particularly careful consideration by the district court." *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1105 (2nd Cir. 1972). While "there may be circumstances where a district court should temporarily freeze defendants' assets to insure that they will be available to compensate public investors," under certain circumstances freezing assets "might thwart the goal of compensating investors if the freeze were to cause such disruption of defendants' business affairs that they would be financially destroyed. Thus, the disadvantages and possible deleterious effect of a freeze must be weighed against the considerations indicating the need for such relief." *Id.* at 1106.

Appendix C

C. *Securities Laws*

1. *Violation of § 10(b) of the Securities and Exchange Act of 1934*

Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

In order to state a *prima facie* case of a violation of § 10(b) and rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, a plaintiff must demonstrate: 1) damage to plaintiff, 2) caused by reliance on defendant's misrepresentations or omissions of material facts, or on a scheme by defendant to defraud, 3) made with scienter (i.e., an intent to deceive, manipulate or defraud, or possibly with reckless disregard), 4) "in connection with" the purchase or sale of securities, and 5) furthered by defendant's use of the mails or any facility of a national

securities exchange. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976); *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32, 243 (1988); 15 U.S.C. § 78j(b). Statements are material if a reasonable investor would consider them important in the total mix of information available. *Basic*, 485 U.S. at 231-32. The phrase "in connection with" has been construed quite broadly. *See Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971). Fraudulent statements are "in connection with" the purchase or sale of securities if they "touch" upon the purchase or sale of securities. *Id.* at 12-13. "Section 10(b) must be read flexibly, not technically and restrictively." *Id.* Where there is a "sale" of a security and fraud is used "in connection with" it, there is redress under § 10(b). *Id.*

2. *Violation of § 17(a) of the Securities and Exchange Act of 1933*

Section 17(a) of the Securities and Exchange Act of 1934, 15 U.S.C. § 77q(a), provides:

> (a) Use of interstate commerce for purpose of fraud or deceit
>
> It shall be unlawful for any person in the offer or sale of any securities or any security-based swap agreement . . . by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly

> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

To establish a violation of § 17(a), the plaintiff must make a showing similar to that which is required under § 10(b), although negligence is sufficient to establish liability under §§ 17(a)(2) and (3). *Aaron v. SEC*, 446 U.S. 680, 695-97 (1980). Section 17(a)(1)'s language, "to employ any device, scheme, or artifice to defraud," "plainly evinces an intent on Congress' part to proscribe only knowing or intentional misconduct." *Id.* at 696. By contrast, § 17(a)(2)'s language, "by means of any untrue statement of a material fact or any omission to state a material fact, "is devoid of any suggestion of a scienter requirement." *Id.* And §§ 17(a)(3)'s language, "to engage in any transaction, practice, or course of business which *operates* or *would operate* as a fraud or deceit," "plainly focuses upon the *effect* of particular conduct on members of the investing public, rather than upon the culpability of the person responsible." *Id.* at 697. In actions brought by the S.E.C. under §§ 17(a)(1) and 17(a)(3), "it is irrelevant whether the scheme succeeded or failed." *Trussell v. United Underwriters, Ltd.*, 228 F. Supp. 757, 767 (D. Colo. 1964).

3. *Violation of §§ 206(1) and (2) of the Advisers Act of 1940*

Section 202(a)(11) of the Advisers Act of 1940, 15 U.S.C. § 80(b)-2(a)(11) defines an investment adviser as, among other things, as any person who, for compensation, engages in the business of advising others as to the value of securities or as to the advisability of investing in, purchasing or selling securities. Sections 206(1) and (2) of the Advisers Act of 1940, 15 U.S.C. § § 80b-6(1), (2), makes it

> unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
>
> (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

Scienter is a necessary element for a claim under § 206(1) but not under § 206(2). *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992).

D. *Securities Violations*

The SEC has alleged that each defendant in this case played a role in a scheme to defraud investors in connection with the fraudulent offering of securities. The Court agrees. The SEC has met its burden of demonstrating that it is likely

to succeed in proving that all of the defendants violated §§ 10(b) or 17(a) of the Securities and Exchange Act, and that Fife, as an investment adviser under the Advisers Act, also violated §§ 206(1) and 206(2) of the Advisers Act. Defendants Herula, Fife, and Capalbo, made intentional misrepresentations to investors concerning investments in the "investment programs" discussed above, Fife's management of investor funds, or the status of investor funds. Defendants Berula and Fife misrepresented the nature of the investment program, its overall risk, and the status of funds after they were placed with Brite Business S.A., Brite Corp. and/or the accounts at Raymond James and/or Charles Schwab. Capalbo misrepresented the status and location of investor funds and, in addition, facilitated the solicitation of those investor funds by lending her name and status as an attorney to two of the accounts in which investor funds were placed. Khan (in addition to the other defendants), at the very least, has been shown to have engaged in a course of business that would operate as a fraud or deceit upon the purchaser, establishing a violation under §§ 17(a)(1) and 17(a)(3).[4]

In addition, upon evaluating the *Cavanagh* factors enunciated above, the Court finds that the SEC has demonstrated a strong likelihood that violations may occur in the future if these defendants are not enjoined. Clearly, a large amount of investor funds have been misappropriated, yet none of the defendants seems to be able to provide an explanation concerning the whereabouts of those monies.

4. Seaview is, in effect, the alter ego of Fife and Khan. As such, the Court's rulings as they apply to Fife and Khan, are equally applicable to Seaview.

Rather, they claim ignorance or lay the blame at the feet of their co-defendants. Moreover, the scheme to defraud was not an isolated incident. A number of investors were solicited over more than two years. Additionally, the acts alleged by the SEC involved intentional misrepresentations. Lastly, by virtue of their occupations, and based on the recency of their alleged conduct and the continuing existence of the accounts and entities used to perpetrate the alleged scheme in this case, the Court finds a strong likelihood that future violations of the securities laws may occur if these defendants are not enjoined from such behavior.

The Court also finds that an order freezing these defendants' assets is appropriate in this case. The evidence presented by the SEC indicates that without that order, there is a high risk that any remaining investor funds, or the proceeds thereof, may be further depleted. Therefore, in order to preserve any remaining investor funds, the Court deems it appropriate it to continue the freeze on these defendants assets, subject to modification pending the SEC's receipt of an accounting from each of the defendants.

Accordingly, the Court finds that the SEC has demonstrated the necessity for a preliminary injunction enjoining all defendants from future violations of the securities laws, as well as for an order freezing defendants' assets.

Appendix C

IV. CONCLUSION

For the reasons outlined herein, the Court granted the SEC's motion for a preliminary injunction enjoining future violations of the securities laws, and for an order freezing the assets of defendants' Herula, Fife, Capalbo, Khan, and Seaview. In addition, this Court orders these defendants to make a complete accounting to the SEC within twenty (20) days from the date of this order.

SO ORDERED.

s/ Mary M. Lisi
Mary M. Lisi
United States District Judge
May 1, 2002

Supreme Court, U.S.
FILED
APR 14 2003

No. 02-1175

In the Supreme Court of the United States

MARTIN D. FIFE AND
FAROUK A. KHAN, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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QUESTIONS PRESENTED

1. Whether petitioners' fraud was "in connection with the purchase or sale of any security," in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), or "in the offer or sale of any securities," in violation of Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a).

2. Whether the preliminary injunction entered against petitioners was based exclusively on inadmissible evidence.

3. Whether petitioner Fife was an "investment adviser" as defined in the Investment Advisers Act of 1940, 15 U.S.C. 80b-2(a)(11).

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SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-21a) is reported at 311 F.3d 1. The memorandum and order of the district court (Pet. App. 59a-81a) and the amended preliminary injunction order and order freezing petitioners' assets (Pet. App. 22a-58a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on November 6, 2002. The petition for a writ of certiorari was filed on February 4, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

The Securities and Exchange Commission (SEC or Commission) brought this civil law enforcement action in the United States District Court for the District of Rhode Island against petitioners and others, alleging, *inter alia*, that petitioners engaged in securities fraud, in violation of Section 17(a) of the Securities Act of 1933 (Securities Act), 15 U.S.C. 77q(a), and Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5. The Commission also alleged that petitioner Fife engaged in fraud as an investment adviser, in violation of Section 206(1) and (2) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-6(1), (2). After a hearing, the district court found that the Commission had made out a prima facie case that petitioners engaged in those violations, preliminarily enjoined petitioners from further violations of the provisions, and froze petitioners' assets pending a final adjudication of liability. Pet. App. 22a-81a. The court of appeals affirmed the district court's judgment. *Id.* at 1a-21a.

1. During 1999 and 2000, defendant Michael A. Clarke raised approximately $51.75 million from five investors, first on behalf of an entity called Brite Business, S.A., and later through Brite Business Corporation. Clarke promised extraordinary returns, such as a $20 million profit in the first 12 banking days. Pet. App. 3a.

Petitioner Fife agreed to manage and invest Brite Business funds in return for a commission. Fife testified during the SEC's investigation that he was to develop a "balance sheet enhancement program," under which investor funds would be pooled and leveraged by purchasing Treasury Bills on margin and then invested

in Third World development projects. The profits from those investments, which Fife claimed would be from 30% to 100% per year, would then be distributed to investors. Pet. App. 4a.

In October 1999, Fife established a brokerage account in the name of Brite Corporation at the Rhode Island branch office of Raymond James Financial Services, Inc., and deposited $44.5 million of the investor funds into it. Fife was the signatory on the account, and his acquaintance Dennis S. Herula, a Raymond James employee, was the designated registered representative. Pet. App. 4a. Mary Lee Capalbo, an attorney and Herula's wife, established a separate brokerage account at Raymond James (the Capalbo Account), on which she was the signatory. *Id.* at 5a.

In March 2000, Brite entered into an agreement with Rheaume Holdings, which was represented by Robert Curl. Under the agreement, Rheaume invested $12.5 million in Brite. On May 8, 2000, Fife wrote a letter to Curl and Rheaume in which Fife stated that ensuring "the safety, security, monitoring and auditing of our client funds is and always will be my primary function. So without hesitation I state to you that absolutely your deposit is safe, secure, unencumbered, will not be invested without your authorization, can not be moved, or withdrawn without your approval." Pet. App. 7a. He stated, with regard to the enhancement program, that "I myself have been successful for the past six months doing the same placement of funds." *Ibid.* And he further represented that there would be "no risk of loss" and that Rheaume would receive benefits from its investment in the next two weeks. *Ibid.*

Almost immediately after Rheaume's investment was in Fife's control, he began transferring funds from the Brite account to the Capalbo account. Pet. App. 8a. By

September 2000, Fife had transferred $15.5 million from the Brite account to the Capalbo Account, where it was invested in securities in the form of money market shares. *Id.* at 5a-6a. Neither Curl nor anyone else at Rheaume authorized those transfers and securities purchases. *Id.* at 8a.

Of the $29 million remaining in the Brite account, $27.3 million was returned to investors. Three investors received back all of their money plus additional amounts, but Rheaume received only a few thousand dollars of its $12.5 million. Another investor, Rashad Mohamed Mahran Al Bloushi, also got back only a small portion of the amount he had invested. Pet. App. 5a.

The rest of the investor money was dissipated: Fife directed that approximately $8 million be used for his and others' benefit. Pet. App. 6a. He "loaned" hundreds of thousands of dollars to a friend and to petitioner Khan, on behalf of Seaview, an entity in which he and Khan were partners. *Id.* at 6a & nn.7, 9. He paid millions to other entities that were supposed to help in the balance sheet enhancement program, but which turned out to be scams. *Id.* at 6a & nn.8, 10. Fife also used $1.5 million of Rheaume's money to pay one of the other investors, whose funds were returned in their entirety. *Id.* at 5a n.4, 7a n.11. In addition to the funds that Fife misused, Capalbo and Herula took $8.6 million for themselves. *Id.* at 7a. By September 18, 2000, all of the investment money that had been placed under Fife's control in the Brite account was gone. *Id.* at 6a.

In the meantime, Fife continued to deceive Curl about the status of Rheaume's investment. In July 2000, Curl requested a report of the balance in Rheaume's account. Fife forwarded to Curl letters from Herula purporting to report Rheaume's investment plus accrued interest in the Brite Account at

Raymond James. Those reports were false because by then the money in the Brite Account was nearly depleted. After several months, Curl requested the return of Rheaume's funds, but Fife falsely told him that the money could not be returned because Raymond James was worried about large sums of cash coming into and going out of an account in a short period of time. Pet. App. 8a.

A few months later, Fife suggested to Curl that Rheaume transfer its $12.5 million investment plus accrued interest, which was supposed to be in the Brite Account at Raymond James, to an account at Charles Schwab in order to facilitate a "swift return" of those funds. Pet. App. 8a. Then he informed Curl that the money had been transferred and forwarded statements purporting to show that the money was in an account in Capalbo's name at Schwab, where it was supposed to be pooled with other investor money and invested in securities. *Id.* at 8a-9a; C.A. App. 11. No funds were ever moved to Charles Schwab or invested in securities there. Pet. App. 9a.

When Curl again requested return of the funds, Fife falsely told him that the National Association of Securities Dealers (NASD) had frozen the account. Fife offered to use the money in other finance deals once the NASD released the money, and stated that he would be able to use Rheaume's money to generate excellent returns on other project finance deals. In fact, no Rheaume money was in the Schwab account because it had all been dissipated. Pet. App. 9a.

In December 2001, Khan sent letters to Al Bloushi soliciting his further investment in a similar investment proposal. He promised huge returns "without any risk." Pet. App. 10a.

2. a. In April 2002, the SEC brought this civil law enforcement action against petitioners and the others who perpetrated the Brite scheme. The SEC charged that petitioners had violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and that petitioner Fife had engaged in fraud as an investment adviser, in violation of antifraud provisions of the Investment Advisers Act of 1940. The district court granted the SEC's motion for a preliminary injunction and froze petitioners' assets pending final adjudication of the SEC's complaint. Pet. App. 22a-81a.

b. The court of appeals affirmed the district court's grant of the preliminary injunction and asset freeze. Pet. App. 1a-21a. As to the Securities Act and Exchange Act fraud claims, the court found that the Commission's evidence established that petitioners made material misrepresentations with scienter when Fife made a series of misrepresentations to Curl about the investment program and about how he had handled, and would handle, Rheaume's funds, and when Kahn represented to Al Bloushi that the Brite investments were safe. *Id.* at 17a-18a. The court further held that the misrepresentations were made in connection with the purchase or sale of securities. *Id.* at 19a.

As to the Investment Advisers Act claim, the court of appeals held that Fife met the statutory definition of an investment adviser because he advised Curl regarding Rheaume's investment, and that he "made various transfers of Rheaume's money without prior authorization, invested money in money market accounts without prior authorization, and falsely represented the status of Rheaume's funds." Pet. App. 19a-20a. The court further held that Fife was working "for compensation," even though he had not yet agreed on the

precise terms of payment, because "he understood that he would be compensated for his efforts by a commission based on a percentage of the profits from the investments, *if successful*, pursuant to a formula to be agreed upon at a later time." *Id.* at 20a.

ARGUMENT

The decision of the court of appeals is correct, and it does not conflict with any decision of this Court or another court of appeals. Petitioners' fact-bound challenges to the court of appeals' decision do not warrant this Court's review.

1. Petitioners first contend (Pet. 10-20) that their fraudulent conduct was not "in connection with the purchase or sale of any security," within the meaning of Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5, or "in the offer or sale of any securities," within the meaning of Section 17(a) of the Securities Act, 15 U.S.C. 77q(a). But the court of appeals correctly applied the established law concerning those provisions, as recently clarified by this Court in *Securities and Exchange Commission* v. *Zandford*, 535 U.S. 813 (2002), to the particular facts of this case. That case-specific application of settled law does not warrant this Court's review.

Petitioners argue (Pet. 15-20) that they are not responsible for false representations made by others before Rheaume's funds were initially invested, and that the false representations that petitioners themselves made were not "in connection with the purchase or sale of any security" because they occurred after the initial investments.[1] That argument, however, over-

[1] The record demonstrates that petitioners were full and knowing participants in the entire fraudulent scheme. Therefore, they violated Section 10(b) and Rule 10b-5, regardless of when or

looks the fact that Fife made unauthorized purchases and sales of securities after the May 2000 letter, which promised that he would buy and sell securities only with Rheaume's authorization. See Pet. App. 5a-6a, 8a. Petitioners' argument also ignores later false representations to Curl about other purchases in order to cover up the misappropriation of Rheaume's money, thus delaying or preventing detection of the scheme. See *id.* at 8a-9a.[2]

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whether they personally made any verbal misrepresentations, because that fraudulent scheme was in connection with the purchase or sale of securities. See 15 U.S.C. 78j(b) (prohibiting use "in connection with the purchase or sale of any security" of "any manipulative or deceptive device or contrivance"); 17 C.F.R. 240.10b-5 (making it unlawful for any person "[t]o employ any device, scheme, or artifice to defraud" or "[t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security"). The judgment of the court of appeals upholding the preliminary injunction and asset freeze can be sustained on that ground. The court of appeals, however, upheld the injunction based on petitioners' own misrepresentations, and, as explained in the text following this note, that determination was also correct.

[2] Petitioners' argument also incorrectly assumes that, once Rheaume had made the initial decision to invest in Brite, it made no further decision to continue or to renew that investment. Rheaume's initial investment in Brite, made in March 2000, was limited to 90 days. See Pet. App. 7a; C.A. App. 14. Fife sent his false May 2000 letter before the expiration of that 90-day period. Curl did not request return of Rheaume's funds until well after the end of the 90-day period, Pet. App. 8a, and his failure to request return of the funds at the end of the 90 days amounted to a decision to reinvest in the program. The record establishes that Curl chose to leave Rheaume's money invested in Brite beyond the initial 90-day period in part because he had confidence in Fife, based on Fife's false representations about the safety of the money. C.A. App. 9-11.

As the court of appeals explained, the May 2000 letter promised that Rheaume's money would not be transferred or used for securities transactions without Rheaume's knowledge and authorization. Pet. App. 7a. But Fife thereafter transferred money out of the Raymond James account into the Capalbo account without any authorization from Rheaume. *Id.* at 8a. And "[t]he funds in the Capalbo account were invested in securities without Rheaume's knowledge or authorization." *Ibid.*[3]

The court of appeals also explained that, later in the scheme, Fife recommended that Rheaume transfer $12.5 million to a Capalbo Account at Charles Schwab, Pet. App. 8a, and then falsely told Rheaume that those funds had been pooled with other investor funds in the Schwab account, *id.* at 9a. Fife further represented that, while the money was held at Schwab, it would be invested in money market shares. C.A. App. 11. In fact, the funds were never transferred to Schwab and used to purchase money market shares there. See Pet. App. 9a. The court of appeals correctly relied on those material misrepresentations about actual securities transactions and promised securities transactions that were not carried out to conclude that petitioners made material misrepresentations "in connection with the purchase or sale of securities." *Id.* at 19a.[4]

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[3] See also Pet. App. 6a ("As of September 18, 2000, all of the investment money under Fife's control in the Brite Account at Raymond James had been transferred out. The money deposited in the Capalbo Account was used to purchase shares in a money market mutual fund.").

[4] As the court of appeals observed, Khan was Fife's "partner" in the investment program. Pet. App. 10a, 18a. He participated in Fife's fraudulent scheme, *id.* at 10a, and received proceeds from it, *id.* at 6a n.7. Khan was thus a participant in that fraud and liable

Contrary to petitioners' contention (Pet. 10-15), the court of appeals' decision is consistent with established law construing Section 10(b)'s "in connection with" requirement and is squarely supported by this Court's decision in *Zandford*. Although petitioners cite various court of appeals and district court decisions (Pet. 10-11, 14-15) which they contend conflict with the decision in this case, petitioners' claim of conflict (to the extent that they explain it) is based on the mistaken premise that no securities transactions occurred after petitioners' misrepresentations. Moreover, all of the lower court cases cited by petitioners predate this Court's recent decision in *Zandford*.

The *Zandford* decision fully supports the holding of the court of appeals in this case. In *Zandford*, the Court reiterated its long-standing view that the securities laws "should be construed 'not technically and restrictively, but flexibly to effectuate [their] remedial purposes.'" 535 U.S. at 819 (quoting *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, 151 (1972), and *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 195 (1963)). And the Court specifically endorsed the SEC's long-standing position "that a broker who accepts payment for securities that he never intends to deliver, or who sells customer securities with intent to

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under Section 10(b) and Rule 10b-5 for that fraud even though he did not personally make any verbal misrepresentations before any securities transactions. See note 1, *supra*. Furthermore, Khan made fraudulent offers of securities to investor Al Bloushi, see Pet. App. 10a, and he therefore violated Section 17(a) of the Securities Act, which does not use the phrase "in connection with the purchase or sale of any security," but instead requires that the fraud be "in the *offer* or sale of any securities." See 15 U.S.C. 77q(a) (emphasis added). Khan's violation of Section 17(a) provides an independent basis for the relief awarded against him.

misappropriate the proceeds, violates § 10(b) and Rule 10b-5." *Ibid.* (citing *In re Bauer*, 26 S.E.C. 770 (1947), and *In re Southeastern Securities Corp.*, 29 S.E.C. 609 (1949)).

Petitioners engaged in the kinds of fraudulent activity that the Court in *Zandford* held are "in connection with" the purchase or sale of securities. When, without authorization, Fife sold money market shares in the Capalbo account so that he and Khan could use the money for unauthorized expenditures, Fife sold "customer securities with intent to misappropriate the proceeds." 535 U.S. at 819. And when Fife falsely promised to sell Rheaume's $12.5 million investment and use the proceeds to purchase money market shares at Schwab, he acted much like a stock broker who "accepts payment for securities that he never intends to deliver." *Ibid.*[5]

Although no securities were actually purchased in the Schwab Account, the false promise to purchase securities that the defendant has no intention of delivering is a violation of the Section 10(b) and Rule 10b-5. See *Zandford*, 535 U.S. at 823-824 (citing *Wharf (Holdings) Ltd.* v. *United Int'l Holdings, Inc.*, 532 U. S. 588 (2001)). Moreover, the subsequent misrepresentations that the promised transactions had occurred (see Pet. App. 8a-9a) were a further aspect of the fraud. See *SEC* v. *Holschuh*, 694 F.2d 130, 143-144 (7th Cir. 1982).

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[5] The only difference is that Fife did not "accept payment" at that time because he already had possession of and had spent most of Rheaume's funds, and Capalbo and Herula had taken the rest. In the situation described by the Court in *Zandford*, the fraudulent promise to purchase securities allows the broker to obtain the funds that he plans to misappropriate. In this case, the fraudulent promise to purchase securities allowed Fife to conceal that he had already misappropriated Rheaume's funds.

In short, petitioners engaged in a protracted course of conduct, involving various real and purported transactions in securities, for the purpose of diverting the money invested by Rheaume into secret unauthorized transactions that benefitted petitioners and others. Thus, this case, like *Zandford*, involves "a fraudulent scheme in which the securities transactions and breaches of fiduciary duty coincide. Those breaches were therefore 'in connection with' securities sales within the meaning of § 10(b)." 535 U.S. at 825.

2. Petitioners also seek (Pet. 20-23) this Court's review of the question "whether a preliminary injunction and/or asset freeze can be based exclusively on inadmissible evidence." Pet. 20. But that question is not presented by this case. Neither the district court nor the court of appeals held that a preliminary injunction or asset freeze can be based on only inadmissible evidence. Moreover, the injunction and freeze imposed in this case are amply supported by admissible evidence, and petitioners' fact-bound contention that those orders are not adequately supported by such evidence does not warrant this Court's review.

The SEC introduced substantial evidence in support of the preliminary injunction and asset freeze, including sworn investigative testimony that the Commission had taken from Fife and Khan, an affidavit from Curl, and documents obtained from them, the authenticity of which has not been questioned. C.A. App. 9-18 (Curl affidavit and exhibits); C.A. App. 159-311 (Fife testimony); C.A. App. 312-318 (Khan testimony); C.A. App. 438-443, 455-466, 471-480 (documents). The district court directed the Commission to produce a live witness, and the Commission presented Bradford Ali, the staff attorney who had conducted the investigation, to offer the documents. But it was the documents

themselves, not the attorney's testimony, that provided the basis for the district court's decision.

3. Petitioners also mistakenly contend (Pet. 23-27) that the court of appeals erred in concluding that Fife acted as an investment adviser. Petitioners do not claim that the court's decision on that issue conflicts with the decision of any other court; nor do they explain why that fact-specific determination warrants this Court's review.[6]

The Investment Advisers Act, 15 U.S.C. 80b-6(1) and (2), prohibits fraud by an "investment adviser," which is defined to include "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities." 15 U.S.C. 80b-2(a)(11).

As the court of appeals explained, Fife fits well within that definition. Pet. App. 19a-20a. When Fife recommended that Curl transfer Rheaume's funds from the Raymond James account to a money market fund at Charles Schwab, he advised a client as to the advisability of investing in, purchasing, or selling securities. More fundamentally, it has long been recognized that the Investment Advisers Act covers those who "'advise' their customers by exercising control over what purchases and sales are made with their clients' funds," which is what Fife was supposed to do under his

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[6] The court of appeals' holding that the SEC made a prima facie case that Fife was an investment adviser and that he violated the antifraud provisions of the Investment Advisers Act provides an independent basis for all of the relief granted against Fife. It is thus another reason why petitioners' challenge to the court of appeals' holdings regarding Section 10(b) and Section 17(a) does not warrant this Court's review.

arrangement with Brite. *Abrahamson* v. *Fleschner*, 568 F.2d 862, 870-871 (2d Cir. 1977), cert. denied, 436 U.S. 905 and 913 (1978); see *United States* v. *Elliott*, 62 F.3d 1304, 1310-1311 (1995), as amended, 82 F.3d 989 (11th Cir.), cert. denied, 519 U.S. 859 (1996).

The court of appeals also correctly concluded (Pet. App. 20a) that Fife was working "for compensation." 15 U.S.C. 80b-2(a)(11). Fife himself testified that he expected that he "would be compensated" by receiving "a percentage of the profits" from the program. C.A. App. 198. Payment of a percentage of the profits from an enterprise is a recognized form of "compensation" under the Investment Advisers Act. See *Elliott*, 62 F.3d at 1310-1311; *Abrahamson*, 568 F.2d at 870.

Fife argues (Pet. 26) that, although he expected to be paid, he was not subject to the obligations of an investment adviser because he had not been paid at the time of his fraudulent conduct. Nothing in the text of the Investment Advisers Act specifies that payment must be received before the fraudulent conduct occurs. And it would seriously undermine the protection provided by the Act if an adviser were not covered by the anti-fraud provisions until after he receives payment for his adviser services. For the same reasons, Fife is not outside the Act's coverage because the terms of his payment had not yet been finalized. The Act seeks to prevent fraud by those in the business of providing investment advice, and Fife was acting in that capacity. The court of appeals therefore correctly concluded that Fife was an investment adviser.[7]

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[7] Fife may also be deemed to have received compensation because he used a substantial amount of the money that he had been entrusted to manage and invest for his own purposes, including making "loans" to his friends and an entity he controlled.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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